Principles of Auditing

BY

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DEDICATED

TO

MR. ELIJAH WATT SELLS

PIONEER, AUTHORITY

GENTLEMAN

FOREWORD

A young man came to New York with the intention of entering the profession of accountancy. He was energetic and ambitious; had a good general education and some experience in accounting work. He obtained employment with a firm of certified public accountants. The usual grind of footing and checking followed for a while; always under the direction of the man in charge of the engagement. Finally came the long sought chance to go out on an engagement alone. He received no instructions; in fact he never had received any instructions about how the work should be done. What he had learned had been learned by observation. He had been afraid to ask questions for fear such procedure would create the suspicion that he did not know as much about his work as he should. For the same reason when sent on the engagement alone he did not ask for working papers and reports which would serve as guides. The result of his work almost proved disastrous. Conscientious and careful as the work had been the report, although prepared with great pains, was not in the form used by the firm. When it was reviewed by the report department it was not only torn to pieces and made over but the accountant was held up to ridicule before a number of persons who happened to be in the room.

This unfortunate experience would have broken the spirit of some men. In this case it only served to lash the subject into a frenzied determination to succeed in the field of endeavor which he had chosen.

How he toiled far into the night for several years while carrying on his daily work, at the same time getting a technical education, as well as some of his many and varied experiences, might make an interesting story but they have no place here. Some of the things he was never able to find in books and about which he was too proud to ask are set forth in this book.

It is dedicated to a man who represents all that is fine and noble in a professional man; one who cannot help but be an inspiration to all who come in contact with him.

FOREWORD

The author's one regret is that the book is not more thorough and polished on account of the man to whom it is dedicated; his one hope that it may lend a helping hand to some young man struggling along the rocky road that leads to success.

John Raymond Wildman.

New York University,
February 1, 1916.

CONTENTS

Principles of Auditing

CHAPTER I

Auditing Defined

Auditing is required because someone may through ignorance, carelessness or intent, have failed to record, express or report, carefully and accurately, facts concerning financial transactions. If no one were ignorant, or careless, or had bad intentions, or there was no lack of confidence on the part of any one, probably one half of the occasions for auditing would be removed. If all facts concerning financial transactions were carefully and accurately recorded and expressed and reported it is almost safe to say that the other one half of occasions in which auditing is required would be removed. The familiar expression "to err is human" is especially applicable in the case of auditing. All are prone to make mistakes. Auditing then practically means searching for mistakes; reviewing the work of others in an effort to discover errors. It might be more charitable perhaps to say that auditing is reviewing the work of others in an effort to prove its correctness. The kind of an auditor which one is to become will depend perhaps very largely on which attitude one assumes, namely, searching for the mistakes of others or trying to prove the correctness and accuracy of the work examined.

Auditing is not accounting nor is it accountancy. Accounting is the science which treats of the systematic record, compilation and presentation in a comprehensive manner for purposes of administration, or the information of other parties at interest, of the facts concerning the financial operations of a business or other organization.

Accountancy is most aptly defined in the Certified Public Accountant syllabus issued by the New York State Education Department as "a profession, the members of which, by virtue of their general education and professional training, offer to the community their services in all matters having to do with the recording, verification and presentation of facts involving the

acquisition, production, conservation and transfer of values. "Accountancy comprehends the conduct of audits, examinations and investigations; devising and installing systems; criticising organizations and management; and in some cases efficiency work.

Auditing is therefore seen to be a branch of accountancy, which profession is as much broader in its scope than auditing is in turn broader in scope than accounting. To perform the functions of an auditor intelligently and successfully, one must have a thorough knowledge of accounting.

Auditing may be defined as the art of reviewing the work incident to the record, compilation and presentation of the facts concerning financial transactions. Autditing, it will be noted, is said to be an art. With regard to accounting it was said to be a science. Auditing is referred to as an art because it has a set of rules. If one were able to conceive of all the possibilities in auditing it is probable that a set of precise rules could be laid down which would be sufficiently comprehensive to enable an intelligent person with a knowledge of accounting to do everything that is necessary to be done in auditing. For example, there being a possibility of error in the footing of a column of figures, if one wishes to determine whether or not the footing is correct, it is only necessary to re-foot the column. If it were desired to ascertain the correctness of certain cost statistics, such as the cost per ton of a certain amount of coal mined, having the facts as to the cost of the coal and the mining thereof and the number of tons mined, a rule for accomplishing the purpose would consist in instructions to divide the cost of the coal by the number of tons. There is no disputing the fact that it requires ingenuity and judgment to become a good auditor. That matter is, however, quite apart from the distinction between accounting as a science and auditing as an art.

Auditing may be professional or non-professional. Which it is depends very largely upon the auditor. If he offers his services to the public, it is professional auditing. If he confines his efforts to one organization, it is non-professional auditing.

CHAPTER II

The Occasions for Auditing

Modern business organizations in a great number of instances have become so great and so complex as to have passed beyond the limit of observation of the individual. It is impossible as a rule for the president of a company or the proprietor of a business to be in touch personally with what is going on in every division or department of his organization. One striking exception to this rule is the case of a young man in New York City, who is the proprietor of a concern engaged in the manufacture and sale of ladies' neckwear. The concern occupies one entire floor of a loft building in a section of the city where similar concerns are found. The plant, altho a comparatively small one, is organized and arranged on a scientific basis. The receiving, stock, manufacturing, and the shipping departments are so arranged as to facilitate the proper routing of the work. The office and sales rooms are accessible to all persons who have dealing with the concern. The proprietor has his desk on a raised platform in the centre of the plant so that by turning about in his revolving chair he is able at all times to see what is going on in all parts of the plant. If there is congestion in the manufacturing department or in the shipping department he knows about it at once and may see that the goods are moved along. If trouble arises in connection with some machine it is brought to his attention immediately and the trouble is remedied without loss of time. When goods are received he is in a position to see that they are unpacked, counted and put in stock; that requisitions are filled promptly and that the stock is kept up. This arrangement is, of course, an ideal one and a striking example of an individual who is in touch personally with all the ramifications of the business.

By way of comparison it may be of interest to try and imagine the president of the United States Steel Corporation with its thirty or forty plants endeavoring to follow out the same scheme. It will thus be seen how impossible in many cases it is for the chief executive to be in personal touch with all that is going on. Such an individual requires some artificial means of bringing into his office a picture of what is going on throughout the organization;

something which will enable him to visualize the situation. Accounting is one of the artificial means which enables such men to overcome these difficulties of time, space and distance, and to carry on the work of administration from the results concerning the financial operations which are supplied to them from time to time.

The question may now arise as to whether such individual will accept the information which is presented to him and act upon it without question. The probabilities are that he will, if the organization is a small one where he knows personally the man who prepares the report or furnishes him with the information. If the organization is of any size the chances are that he will not accept and act on the information without taking some steps to satisfy himself as to its accuracy. There are probably many reasons why he would not attend to this matter in person. One reason may be that he is too busy to go out and check up the information himself, and in other instances he is not competent to do it because he does not know where the information came from and how it was compiled nor where the records from which it was taken are kept. A further reason may be that the president is too high-priced an employe to spend his time in work of this nature. Accordingly he makes use of someone at his command. As a rule he sends someone else to do the work for him. He sends someone that he can trust and someone that is competent to do the work. Since these are the results produced by accounting, it naturally follows that he must send someone to verify the results who understands accounting in all its details. The relation is confidential and the person sent, who has the function of auditor, is his personal representative.

Generally speaking it may be said that auditing is done, first, to satisfy someone as to the correctness of the accounts; second, to prove or disprove some contention; third, to influence prospective purchasers of goods or proprietary interests, and prospective creditors.

While the occasions for auditing are numerous and varied, they are probably all comprehended in the following category:

A. At the instance of someone within the organization.

1. To satisfy someone within
2. To satisfy someone without

3. To prove or disprove some contention on the part of someone within
4. To prove or disprove some contention on the part of someone without
5. To influence someone within
6. To influence someone without

B. At the instance of someone without the organization.

1. To satisfy someone without
2. To prove or disprove some contention on the part of someone without
3. To influence someone without

The specific occasions may now be considered in the order in which they would appear in accordance with their relation to the above category.

First, at the instance of someone within the organization to satisfy someone within.

A sole proprietor may frequently be at the head of a business which is sufficiently large to require a more or less elaborate organization. It is probable that except in rare cases such individual will have someone to keep the accounts for him and that he has not the time, patience or training to check up such work himself and will probably realize the necessity sooner or later of employing someone to audit the accounts for him in order that he may be satisfied as to their correctness.

In the case of co-partnership the services of an auditor are perhaps more frequently apt to be required because of the necessity for accuracy in the determination of profits. Since partners are interested in the sharing of profits it is of mutual importance to them that the profits be correctly stated. Here it is that the auditor is frequently needed, not only for the purpose of giving his independent opinion as to the results under normal conditions, but also in case of dispute between or among partners. Parties to a joint venture which is a special form of partnership except that the parties combine their money or efforts in connection with one particular piece of business rather than a series of miscellaneous business transactions extending over a period, are desirous of knowing whether or not the accounts are correct and whether the profits are properly stated in order that each party may know whether or not he is getting his proper share.

Associations or societies supported by membership dues or contributions require the services of an auditor in order that the supervising or directing heads who are responsible for the affairs of the organization may know that the funds have been properly handled and accounted for and in order that proper reports may be made.

Officers and directors of corporations probably have more frequent and greater need for the services of an auditor than any other type of organization. This is occasioned by the elaborate division and departmental organization which is apt to exist under such organizations. Written reports are made use of to an extensive degree. Each employe or group of employes, or department, is in turn reporting to someone higher up. Officers and department heads are constantly having occasion to receive reports from subordinates. The geographical location of various plants or activities of the same organization make it all the more necessary that reports be depended upon. It is undoubtedly in connection with the work of corporations that the auditor, both professional and non-professional, finds the most frequent need for his services.

Analogous to this situation is that in which supervising engineers and companies which finance and manage public utilities, employ a staff of non-professional auditors for the purpose of auditing the accounts of operating companies over which their supervision extends.

Second, at the instance of someone within the organization to satisfy someone without.

While there is a theory to the effect that stockholders are proprietors and that like sole proprietors or co-partners they have a voice in the management of the business, it is probable that such is not actually the case except in a few instances. The average stockholder probably invests his money and takes his dividends if he can get them with little thought as to his rights of management, except as he may present himself or his proxy at some annual or other meeting of stockholders. It is probably not an extravagant statement to say that in the majority of cases stockholders are considered from the point of view of the management as being outsiders who contribute funds with which in part to carry on the business. Such at least is the status of the stockholder in his relation to the management under the above category, and while

some liberty may have been taken in so doing nothing serious is thought to be at stake.

The officers report to the directors and the directors report to the stockholders. It is therefore thought quite important by the directors of many corporations that a complete and comprehensive report of the affairs entrusted to their care should be made to the stockholders, and that such report should have the approval of some qualified independent person before being submitted to the stockholders. Since such reports cover very largely the financial transactions, it is obviously necessary that before such report may be approved by an auditor, that an audit of the accounts shall be made.

CHAPTER III

THE OCCASIONS FOR AUDITING—CONTINUED

The same kind of information which would be interesting to stockholders would be interesting also to bondholders. Bondholders might have to be satisfied in certain instances by means of an audit. In this same class of outsiders would be included creditors in general, and banks in particular. Creditors who have large accounts may be thought worthy of satisfaction through an audit. Likewise, it may be considered desirable to satisfy banks which have large amounts of commercial paper of any given concern, or banks which have applications for loans which it is desired they shall make. The position of any company or organization seeking credit is always very much stronger if the statements presented are supported by certificates of auditors. Following out the same idea there are frequently seen in the daily newspapers published reports of insurance companies which presumably are given out for the purpose of assuring policyholders that the business is being properly conducted and that the accounts have been audited and found correct. In all of the above cases the occasion for the audit arises at the instance of someone within the organization in an attempt to satisfy someone without.

Third, at the instance of someone within the organization to prove or disprove some contention on the part of someone within.

In this connection it may be noted that disputes have been known to arise among the officers as to the honesty, capability or efficiency of employes who have to do with the accounts. Almost any professional auditor of experience will recall disputes which have arisen between some of the officers on the one hand and a plant manager or superintendent on the other. The discussion usually consists of an argument as to whether certain items constitute charges to capital or to expense. The manager is usually trying to make a record by keeping down the expense, and attempts wherever possible to charge questionable items to capital. The officers, on the other hand, are endeavoring to guard against having an eggshell plant built up, the account for which will be full of charges for intangible values which should be charged to expense. Audits are frequently occasioned by the

necessity for determining whether or not such charges have been properly classified.

Fourth, at the instance of someone within the organization to prove or disprove some contention on the part of someone without.

These cases usually take the form of some accusation against the management in connection with the accounts, and an audit is made at the instance of the management in order to refute the accusation. Stockholders sometimes accuse the management of creating superfluous reserves, or making excessive appropriations, or needless expense in order to reduce the profits and consequently keep down the dividends. Charitable agencies have at times been accused of spending more of the funds contributed, for salaries of the administrative officers than in carrying out directly the purposes and objects of the association or society. In these cases where the officers feel aggrieved at the unjust accusation they may cause an audit to be made for the purpose of setting at rest these contentions.

Fifth, at the instance of someone within the organization for the purpose of influencing someone within.

The occasions of this character are perhaps not so frequent as some of the others but one case will at least serve to justify the inclusion of this item in the category. The cashier of a bank in one of the southern cities felt that he was not being fairly treated in the matter of salary by the officers of the bank. In his struggle for an increase in salary he employed a firm of certified public accountants to make an audit of the accounts of the bank at his expense. The audit and subsequent report in this case was used by someone within the organization for the purpose of attempting to influence someone within the organization.

Sixth, at the instance of someone within the organization to influence someone without.

Striking examples of this class are cases in which an attempt is made to sell stock or bonds or a proprietary interest in a business concern. Banks also are frequently influenced in the direction of making loans or discounting notes by the financial condition or result of operations of an applicant, and they are more apt to be influenced when the results are certified after an audit. An enterprising realty company not only had the accounts of its own and the sixteen subsidiary companies audited and the auditor's certificate appended to the published statements thereof, but had

the auditor instruct the salesmen as to the interpretation of the financial statements and the effect of the auditor's certificate on the situation.

Charitable institutions especially are considered to derive benefit from having their accounts audited and appending the auditor's certificate to the financial statements which appear in their printed reports. Contributors past and prospective are thought to be influenced through the knowledge that the funds of the societies in question have been properly used and accurately accounted for. It is unquestionably true that publicity, especially when the information is supported by independent and competent opinion, stimulates interest and support. It may be interesting to know that there are some thirty-six hundred charitable agencies in the metropolitan district, that is to say, charity organizations which are supported either wholly or in part by public contributions. This work is more or less correlated by a central association known as the Charity Organization Society. The Charity Organization Society has a bureau known as the bureau of advice and information which serves these agencies somewhat in the capacity in which the Dun and Bradstreet mercantile agencies serve the mercantile world, in that it classifies, rates and lists these different agencies. If a man like Mr. Rockefeller, for example, is approached by someone for a contribution to some charity and he does not know the person or the society, or whether or not it is worthy, he may refer to the book published by the Charity Organization Society in which these agencies are rated, and perhaps decide whether or not to contribute. The bureau finds it difficult to rate these agencies properly because many of them do not have proper and adequate systems of accounting, and do not make comprehensive reports. It is now a part of the bureau's program to insist that the accounts be audited before agencies are listed.

Under the second division of the category come the occasions which arise at the instance of someone without the organization. These, as before, may be taken up as listed.

First, at the instance of someone without the organization to satisfy someone without.

Subscribers to capital stock may cause an audit of certain accounts to be made in order to satisfy themselves as to the disposition of funds which they have paid into the corporation. Stock-

holders may likewise have made at their own expense, audits in order that they may judge of the efficiency of the management. Directors sometimes want information as to the acts of receivers or trustees. Here, of course, the normal situation is reversed. Ordinarily, the director is an insider. There may come a time, however, when the company goes into the hands of the receiver, and subsequently the trustee carries on the business. Under such circumstances both the receiver and trustee are representatives of the court in behalf of the creditors, while the directors become outsiders. Other illustrations of the above class are beneficiaries under sinking funds, who at times have audits made. There might also be included fidelity companies where bonded employes are suspected of having defaulted. It should not be overlooked incidentally that the employer companies frequently have the accounts of bonded employes audited in order to avail themselves of the lower premium rate which the bonding companies offer in such cases.

Second, at the instance of someone without the organization to prove or disprove the contention of someone without.

Minority and other stockholders sometimes raise contentions concerning the management of the directors or officers and cause an audit to be made. Not long ago a holder of sixteen hundred shares of stock in the Brooklyn Union Gas Company headed a movement of minority stockholders who employed accountants to go over the books for the purpose of proving that certain profits had not been paid out of the dividends.

Bondholders may take similar steps in cases where interest on bonds has not been paid and where it is contended that if certain charges had not been excessive there would have been sufficient profits to have met the bond interest.

Claimants of royalties frequently make the contention that they are not receiving as much as they should and an auditor is engaged by such claimants to determine whether or not the contention is correct. An advertising man who recently closed a contract whereby he was to receive a certain percentage of the sales as his compensation for doing the auditing work, had written into the contract the provision that the accounts should be audited. This was taking the proverbial "stitch in time."

Third, at the instance of someone without the organization to influence someone without.

Bond houses bringing out or selling securities of certain companies serve to illustrate this class. A prominent bond investment house recently had a combination investment consisting of five $1,000 bonds presenting diversity, safety of principal, marketability, liberal income and opportunity of appreciation. It is not probable that the house in question would make a statement such as the above without having satisfied itself through audits as to the financial status of the companies whose bonds were offered. Circulars offering investments are now rare which do not contain a statement to the effect that the books have been audited by some well known firm of certified public accountants. Included in this group should be underwriters, who, preliminary to the consolidation of a number of companies, have the accounts of the companies in question audited. These like the above, it will be seen, are usually occasioned by the desire on the part of someone outside the organization to influence someone also outside.

It may perhaps be said that the object of the discussion just concluded is that proper cognizance may be taken of the party or parties to whom the auditor is to report. It is important at all times that the auditor should determine the party for whom the work is being done in order that he may know to whom his report is to be addressed and delivered. Considerable embarrassment may follow the delivery of a report to the wrong person. In some cases clients are known to have refused payment of the fee because the report was not delivered to the proper person.

CHAPTER IV

Audits Differentiated from Examinations and Investigations

Auditing connotes reviewing accounting work. Reviewing accounting work means reviewing the records which appear on the books, extending from the books of original entry to the general books as well as the financial statements which are prepared therefrom. If one were to trace all the financial transactions of a business it would be necessary to begin with the books of original entry where all the details are shown; to follow these transactions through the intervening stage of classification, combination and grouping into the general ledger and from the general ledger through the trial balance into the balance sheet and statement of income and profit and loss. If one were to make a complete audit it would be necessary to review in its entirety the work incident to the financial transactions just mentioned. Unfortunately the occasions are rare in which it is possible to indulge one's love of thoroughness to this extent. Great is the satisfaction where the operations of the organization under audit are so small in volume as to make it possible to check every figure. In auditing the accounts of a large department store where thousands upon thousands of sales are made in the course of a year, a corresponding number of sales slips would doubtless be encountered. To be absolutely sure that all sales had been accounted for, it would be necessary to examine and verify every one of the sales slips. After verifying the amounts it would be necessary to add them up and trace the totals into the general books. If the work concerning all the various phases of the business were carried out in such detail, the audit would be a complete one. Obviously, however, it would be quite out of the question, except in rare instances, for the professional auditor to attain such degree of thoroughness.

Audits may be complete or partial. The ideal audit is a complete one. While perhaps one of the most unsatisfactory things about auditing is the fact that oftener than otherwise the audit must be a partial one, professional practice has dictated that the client may not as a rule expect more than a partial audit. It

is doubtful if most clients understand what is really meant by testing and it is doubtful if many clients are consulted as to whether or not testing shall be done. It is probably not an extravagant statement to say that testing is a device of which the auditor avails himself in order to satisfy himself as best he may where for one reason or another thoroughness and the amount of time which necessarily accompanies it are out of the question. As an illustration of testing, sales invoices might be taken. Picking out from four to six months, say January, June, July, September, November and December, the sales invoices would be checked against the sales records unless duplicate invoices were used for same; the footings of the sales records for the respective months should be proved and the monthly totals followed forward into the general ledger. The individual invoices should be followed into the customers' accounts. Such procedure is known as testing, and testing usually accompanies a partial audit. Testing should be accompanied by judgment.

An examination differs from an audit in that it attempts to verify results rather than the processes whereby the results were obtained. Results are usually expressed in a financial statement called the balance sheet. An examination, therefore, practically consists in verifying the assets and liabilities including the accountabilities. An examination is frequently referred to as a balance sheet audit.

An investigation is a matter which refers to a transaction, series of transactions or phase of a business, and differs from an examination in that it attempts to ascertain but not prove the facts concerning a transaction or phase of the business from its inception to its termination. In an investigation it might be important to know what details constituted a certain transaction or series of transactions as a matter of information, but the details would probably be accepted without attempting to prove them. It is a difficult matter to state a definite rule for identifying or distinguishing investigations. Contrary to the impression just given, some investigations lead to litigation wherein it is necessary to prove in court all the details involved in the transaction. As generally understood, however, investigations frequently refer to the determination of the earnings of an organization extending over a period of years or a determination of the cost of production, in which cases the records on the books are accepted as being true

and correct, no attempt being made to prove the details which support the conclusion.

While it may not be clear from the preceding discussion as to the exact difference between an audit and an examination or an examination and an investigation, there is one thing about which the student or the young man starting work in the profession should bear in mind, namely, that all engagements are not audits. It is perhaps of greater importance to appreciate this fact and to know that a difference does exist among the various classes of engagements mentioned rather than not to know exactly what these differences are. One of the most pathetic exhibitions a young man may be guilty of is to begin a thorough audit of a set of books when it was intended by the client that he should investigate only a certain matter.

CHAPTER V

The Engagement

The discussion which follows will deal principally with the subject of auditing from the professional point of view. It may be desirable at times to mention the work of the non-professional auditor, but it should be borne in mind that the subject is being generally discussed from the other point of view.

There are certain preliminaries preceding the beginning of an audit which seem to require some attention before going ahead. Some men have jobs, some men have positions; some concerns speak about making sales, other concerns talk about taking contracts, while others will be heard talking about getting jobs. The accountant refers to his work as the taking of an engagement. Engagement is the technical accounting term used to denote that arrangement or agreement which the accountant makes whereby he takes up certain work for a client. The word client as used here is also a technical accounting term indicating the party for whom the work is done. It is analogous to the word customer as used in trading. In business it is considered important that when two parties agree on a certain thing and there is a meeting of the minds that some expression of the agreement or contract, as it is now called, which has resulted shall be recorded. That is, of course, contracts of any importance. Simple matters which two persons are able to remember without any difficulty do not need to be expressed in writing. When a contract becomes so complicated that it is not possible for the parties thereto to remember the facts concerning it, it is usual to express those facts in writing.

Usually in taking engagements there are a number of stipulations to be made; certain things to be done; certain information necessary in order that the work may be carried out intelligently by everyone concerned, and for that reason an engagement blank is prepared. The specimen engagement blank which follows apparently needs no description since it is self-explanatory.

It does not always follow that the work of an engagement will be done in the office of the client. The treasurer of some organization in Wall Street may employ an accountant to audit the ac-

counts of an institution in Forty-second Street. An accountant may be employed at times by one party to audit the accounts of a second party, with the permission, of course, of the second party, so that it is important to have on the engagement blank as much information as possible concerning the engagement. An accurate

Form No. 113

HASKINS & SELLS
CERTIFIED PUBLIC ACCOUNTANTS

MEMO. OF ENGAGEMENT No. 150
ASSIGNED TO
Office, February 5, 1915.

1. Client, Warburton Desk Company,
2. Address, 265 Broadway, New York.
3. Conference, John Wood, President.
4. Letter, dated February 1, 1915.
5. Telephone, Barclay 1894
6. Report to be addressed to, President.
7. Account to be charged in Ledger, Warburton Desk Company.
8. Examination to be made of, same.
9. Where located, as above.
10. Nature of business, Manufacturer of desks.
11. Nature of work, Audit for the year ended December 31, 1914.
12. When to be commenced, February 12, 1915.
13. Probable time required, four weeks.
14. Accountants required, one senior.
15. Rates, usual.
16. Remarks, Report required not later than March 15, 1915.

(Noted: For use of New York office only) By

Specimen Engagement Blank

description of the work to be done is very important since there are a number of people interested in the information. The man who manages the staff wants to know when the work is to be commenced so that he may have the necessary accountants of the

right grade ready at the proper time. He needs to know the probable length of time required so that he may know when such men will be available for other work. It is not always possible to say with exactness how long an engagement will take, but it is possible by using a small amount of time for the purpose of estimating, to determine with a fair degree of accuracy, the length of time required. Take, for example, the vouching of cash disbursements and the footing of the cash book. One may determine very easily the length of time required to check a page of entries containing forty or fifty items and also how long it takes to foot a column of figures that long. With this information it is an easy matter to look through the book and find how many pages of cash disbursements there are. By multiplying the time required for one page by the number of pages, the total time required for vouching and footing the disbursements is ascertained. By applying this test to the various units of work and putting together the time of the various units it is possible to determine approximately the length of time required for the engagement. A liberal percentage must also be added of course to allow for failure of the man performing the work to live up to the schedule, and to a certain extent, to cover unforeseen circumstances. A hasty examination of this kind may not disclose the fact that all vouchers and documents are not of the same type and that numerous vouchers, for example, are supported by many sub-vouchers, which fact was overlooked in making the estimate. Nevertheless, a rough idea of how long a man will be engaged is better than no idea at all.

The probable length of time required on an engagement is of interest not only to the staff manager in order that he may know when the man will be available, but to the man who makes a flat or contract price for an engagement. Incidentally, it is not a good plan to take contract engagements. The element of risk is too great on all sides. The accountant is liable to underestimate the length of time required to do the work and consequently one of three things may happen. Either the accountant will lose money on the engagement or he will make money at the expense of his staff by working the men overtime, or the quality of the work will suffer. While theoretically contract engagements are wrong, as a matter of practice they are common.

If an accountant is working for himself the engagement blank

is handy as a memorandum of conditions. If he is working for some one else it is handy for purposes of information. An ideal engagement blank is one that will convey to any one who has occasion to use it, all the information pertaining to the engagement. The number of copies to be made may differ in different offices. The accountant working for himself needs but one or at the most two. In a large office it is customary to make four copies; the original and three carbons. One goes to the staff manager in order that he may know what to do and when to do it; one copy goes to the financial department in order that the account with the client may be opened and provision made for the charges as they come through; a third copy goes to the file room in order that the man in charge of the file room may be on the lookout for working papers and reports from the respective engagements and in order that he may know to whom to send the report when it is ready to be delivered. The accountant who takes up the engagement receives the fourth copy and requires the information in order that he may proceed with the work intelligently.

Most engagements are carried out in the offices of clients. It would perhaps be more exact to say that the work on most engagements is carried on outside of the office of the accountant. There will occasionally arise, however, engagements where the books are small and the vouchers are few in number and all books and papers may be taken to the office of the accountant and the work done there. In the majority of cases this will not be so.

It has seemed to the author that students might get a better grasp of the subject if each student as he pursues the reading of this text imagines that he is going out on a small engagement where he would do personally all the work. Such, as a matter of fact, is the best kind of experience for the young man. Out of such an engagement where there is an opportunity not only to see but to do the work in its entirety, most benefit is to be derived. Young men about to enter the profession frequently ask the question as to whether it is better to go with a large or with a small concern. It seems to be difficult to decide since each has its advantages and disadvantages. In one case the young man comes in contact with small engagements where he learns all there is to be learned about them. As a rule, however, he sees no large engagements. On the other hand, where he is employed by a

firm of accountants which has large engagements he is apt for a good while to do nothing but detail work and see only a small part of the large engagements. While an ideal concern with which to serve an apprenticeship is one whose work is sufficiently broad in its scope to offer a variety of both small and large engagements, there is one thing to be said in favor of the latter. If the apprentice keeps his eyes and ears open and takes advantage of all his opportunities, what he learns is how to run a large engagement. This may be advantageous to him if he ever starts in business for himself and is fortunate enough to obtain a large engagement. Being familiar with the large engagement he has no hesitancy in accepting it, as he is enabled to carry on the work without fear of failure.

CHAPTER VI

What to Do Before Beginning an Audit

The practical hints which follow may seem to some too trivial to warrant mention. They are admittedly small matters. Just these little things, however, sometimes make the difference between success and failure, in so far as the novice is concerned. The young man starting in the profession has a great many persons to satisfy. There is not only the staff manager but the members of the office force with whom he comes in contact, as well as the senior accountant who has charge of the engagement. There are, in addition, the employes of the client and perhaps the client himself with whom he comes in contact on the engagement. To have his work at all times beyond reproach as he comes in contact with these various individuals, requires constant vigilance. Attention to the small details undoubtedly goes a long way toward giving him a satisfactory status.

The first instructions to be given to an accountant going out on a small engagement might be, "get your engagement blank and your letter of introduction." The engagement blank has already been described. The letter of introduction might read as follows:

JONES AND PARKER,
Certified Public Accountants,
32 Waverly Place,
New York City.

February 12, 1915.

Mr. J. G. Sherman, Treasurer,
Warburton Desk Company,
265 Broadway,
New York.

Dear Sir:

This will introduce our representative, Mr. Arthur Read, who is calling on you for the purpose of taking up the work of auditing the accounts of the Warburton Desk Company.

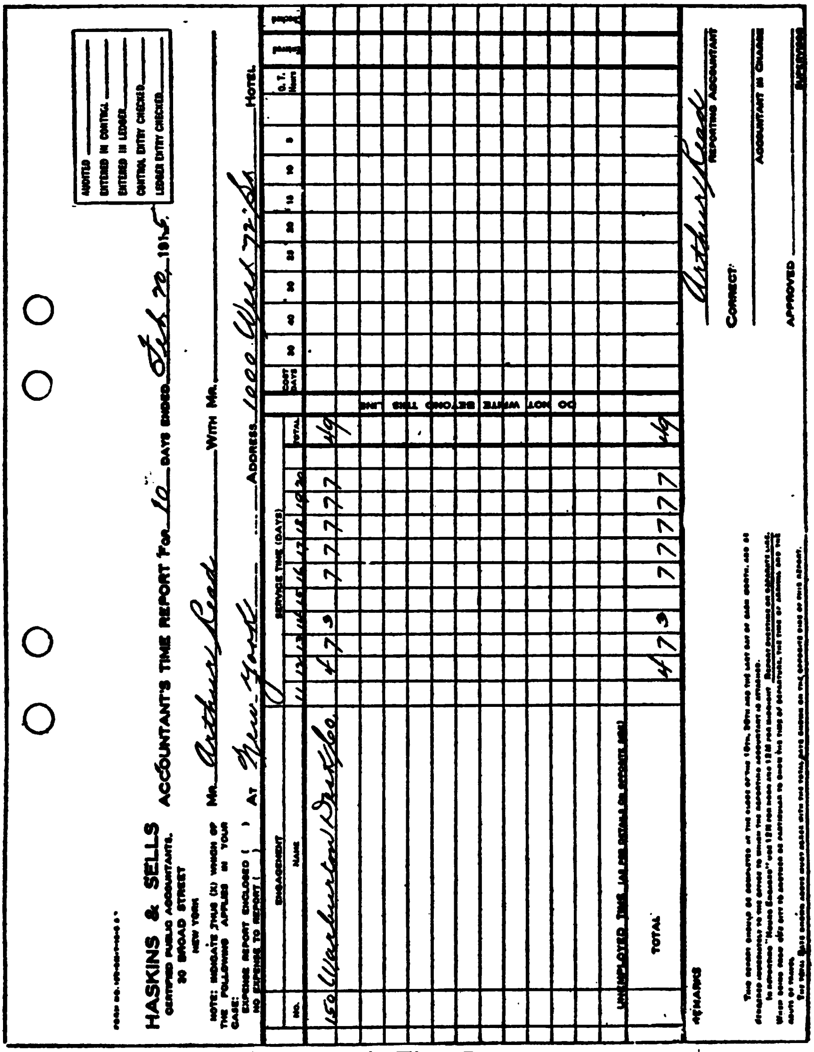
Yours very truly,

(Signed) Jones & Parker,
Certified Public Accountants.

It is not possible in these days and especially in the large cities to walk into an office and begin an examination of accounts which are frequently of a private and confidential nature without credentials of some kind. The nature of the accountant's work and the liberties extended to him are such as to require that he shall be properly introduced and accredited.

Among the other things with which an accountant needs to provide himself before leaving the office, especially if he is going out of town, are time and expense reports, expense funds, railroad and Pullman tickets. It has been said of the professional accountant that one of his compensations is that he is permitted to travel like a gentleman.

Specimen time and expense reports follow:



Accountant's Time Report

DATE	HOURS ENGAGED FROM	TO	PARTICULARS OF WORK	DAYS	
11					
	1-	2-	Audit program		
	2-	2^{30}	Count of cash and securities		
12	2^{30}	5-	Taking trial balance and sending		
			out request for bank certificate	1/2	
	9-	12^{m}	Taking trial balance		
13	1	5-	Footing cash book	1	
14	9-	12^{m}	Footing cash book	1/2	
15			Sunday		
	9-	12^{m}	Footing cash book		
16	1-	5-	Checking bank vouchers into		
			cash book	1	
	9-	12^{m}	Checking bank vouchers into		
17	1-	5-	cash book	1	
	9-	12^{m}	Reconciliation of bank balance		
18	1-	5-	Checking cash postings into		
			ledgers etc.	1	
	9-	12^{m}	Checking cash postings into		
19	1-	5-	ledgers etc	1	
	9-	12^{m}	Analysis of asset and		
20	1-	5-	liability accounts	1	
			TOTAL DAYS		

Reverse Side of Time Report

INSTRUCTIONS—This report should be prepared at the close of the 10th, 20th and last day of each month, and be rendered immediately to the office to which the reporting accountant is attached. Make settlement and include in this report all expenses incurred during the period. Attach receipted bills. Group and total the expenses for each engagement under the proper title thereof, and show each person's expenses separately. In case entire balance of Expense Fund is transferred to another accountant the fact should be reported immediately on this form.

Form 110

HASKINS & SELLS
CERTIFIED PUBLIC ACCOUNTANTS
30 BROAD STREET
NEW YORK

ACCOUNTANT'S EXPENSE REPORT

AUDITED ______
ENTERED IN CONTROL ______
ENTERED IN LEDGER ______
CONTROL ENTRY CHECKED ______
LEDGER ENTRY CHECKED ______

FOR *10* DAYS ENDED *Feb. 20,* 191*5*

Date	Accountants	Details	Total Expenses		DO NOT WRITE BEYOND THIS LINE	Unfinished Engagements		Cost of Engagements		General Expense	
12		Carfare		20							
13		"		20							
14		"		20							
		Postage		10							
16		"		02							
		Carfare		20							
17		"		20							
18		"		20							
19		"		20							
20		"		20							
	TOTAL DISBURSEMENTS		1	72							

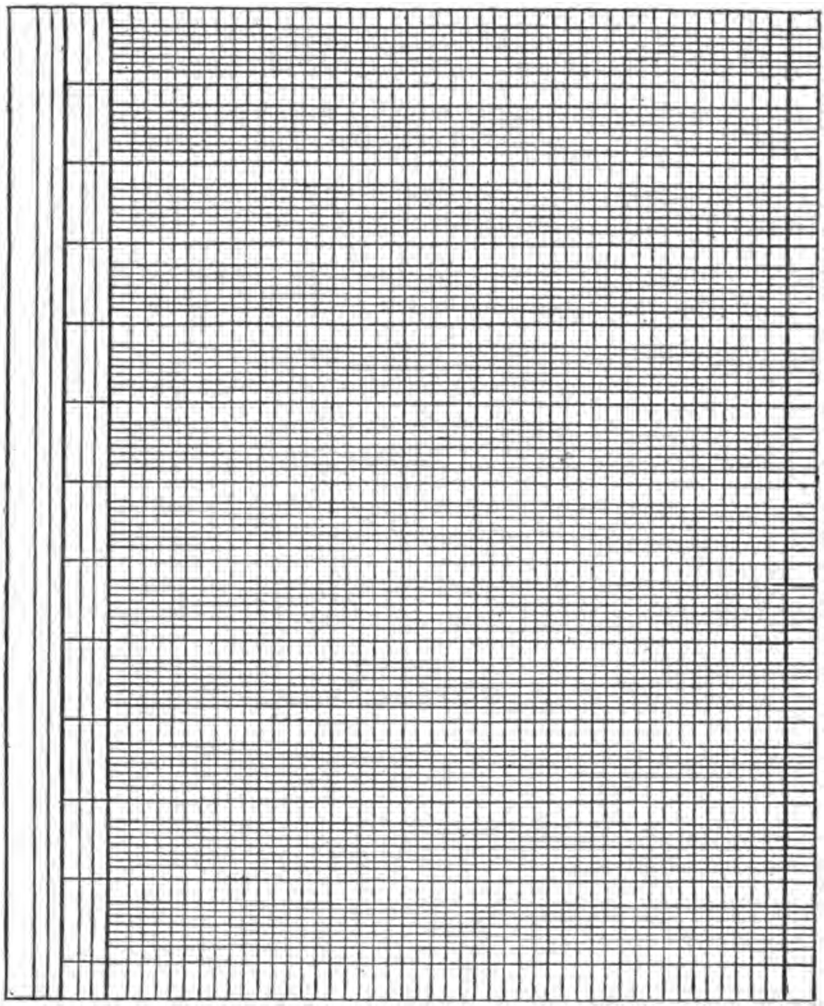
Date	DEBITS			Date	CREDITS		
	Balance due H. & S. (from last report)	8	29		Balance due me (from last report)		
	Received from				Disbursed as above	1	72
	" "				Transferred to		
	" "				Cash returned		
	Balance due me (to next report)				Bal. due H. & S. (to next report)	6	57
	Total	8	29		Total	8	29

APPROVED ______________ SUPERVISOR

SIGNATURE *Arthur Read*

Accountant's Expense Report

The accountant should always provide himself with analysis paper, twelve or fourteen columns, preferably fourteen, since the latter is better adapted to the use of the working sheet. There should also be included in the equipment, journal paper, bank certificates in blank, scratch paper, #2 black pencils, blue and red pencils, a rubber eraser and a small ruler not over twelve inches long. For the benefit of the uninitiated there follows a reproduction of analysis paper.



The accountant's outfit is not complete without a memorandum book or diary. In it he should note daily the engagement on which he is working, the hours during which he has worked and the particulars concerning the work on which he has been engaged. For example, "October 15, Warburton Desk Company —9 to 12; 1 to 5, counting cash and reconciling bank account." This information will be required when the accountant comes to make up his time report. He should also note in this book the details of his expenses so that he may supply these details when making up his expense account.

It is well to preserve these diaries from year to year, since they play an important part at times in case he is called upon to testify in court, and requires something to refresh his memory as to precisely what he was doing on a certain date and at a certain time. The author had occasion during the year 1914 to give testimony concerning work which he did during the year 1907. Two parties to a series of joint ventures which extended over a period of ten or twelve years became involved in litigation. One party disclaimed all knowledge of the conditions of the books and financial statements and pleaded ignorance in these matters. The author was able, through reference to his old diaries, to give dates and hours at which he discussed in detail the conditions of the books and the statements with this particular party. It is needless to say that this evidence was damaging to the party just mentioned. The judge later referred to the testimony as being "precise and convincing." This incident is mentioned simply to illustrate the manner in which an accurate diary may be of considerable value to the accountant in enabling him to appear favorably if called upon to give testimony.

The supplies previously mentioned should be gathered and put into an envelope or bag. A working bag with the nameplate on the outside is of course desirable. A heavy paper or linen envelope will, however, serve the same purpose if the supplies are not too numerous or extensive in quantity. At any rate, the accountant's name and address or the name and address of the firm for which he is working, should be put on the outside of the envelope. This is in order that the envelope may be restored to its owner in case of loss, which is of all the more importance in case the envelope happens to contain old working

papers which may be private in their nature. Accountants have been known to become so engrossed in thinking about their work while traveling on cars and trains as to leave bags or envelopes behind upon quitting the conveyance.

Upon reaching the office of the client the accountant should conduct himself with humility and be polite. Politeness carries a great deal of weight, and humility makes a good impression. To walk into the office of a client with one's hat on and with no regard for the people in the office, tends to create a prejudice in the very beginning. It is perhaps almost unnecessary to say "take off your hat and be polite and friendly but not familiar." Due regard for the client and his employes will frequently open the way for relations which will be pleasant, and in so far as they concern the success of the accountant on that particular engagement, profitable.

No time will be wasted which is spent in getting the employes with whom the accountant comes in contact into the proper frame of mind. The man or woman whose work is to be reviewed will react favorably if given credit for knowing more about the details of the work than the accountant. A man who has been keeping a set of books for some time, obviously knows more about them than the stranger, no matter how expert or learned in his profession he may be. The bookkeeper will appreciate being permitted to feel that this is so and will resent being told that he does not know his business, that the system is poor, or that his methods are old-fashioned. These things may all be so but no good comes of impressing them on the person affected. Because of the fact that he is a human being to do so will be almost sure to make an enemy of him. This, of course, should not be carried to the extent of becoming a hypocrite. One may use tact and diplomacy in approaching a client or his employes without becoming a hypocrite.

Above all things do not assume that all men are "crooks." The auditor who gets that point of view has a miserable time. A better point of view is that of assuming that the auditor is there for the purpose of establishing the fact that everything is right, and assuming that such is the case, until proved otherwise.

The auditor should not make himself objectionable on an engagement by asking too many questions. He should use his brains, think about things and study them out for himself. "Keep

your mouth shut, your ears and eyes open" is a good rule. Many instances have come to notice where accountants have made themselves disliked through the habit of asking numerous and unnecessary questions.

Ideals are excellent, but they should not be allowed to prevail over commonsense. They should be tempered with judgment. Procedure which might be quite proper in general would perhaps need to be changed in a case, for instance, where the stock of a certain corporation is all owned by one man, the report goes to one man, affects no one in the organization but himself and is used for no outside purpose. Certain opinions of such a man may not coincide precisely with those of the accountant. He may wish his books kept in a certain way. The accountant need feel no offense because this is so. He may have the opinion that the ideas of the proprietor are wrong and that his way of doing things are not the most approved, but there is no reason why he should drop the engagement because of this fact. The position of the proprietor may not be a variation of principle but represent rather a difference of opinion. If such a man wishes the accountant to certify to the effect that the accounts are right and properly kept and the accountant feels that they are not all right, it is a different matter entirely. Ethics and honor are two things to be zealously guarded.

Another important thing is to find a comfortable place to work. A table or desk that permits papers to be spread about is desirable. The work should be carried on by daylight if possible rather than by artificial light. The light should come in over the left shoulder if such arrangement can be effected. The auditor will as a rule be more comfortable in a room by himself. This, however, is not always possible. He should learn to work if necessary in a place where there is nothing but noise and confusion. He should school himself so that if it becomes necessary, he may work in a factory where all the machinery is running. He should learn to pull himself into his shell as it were, and shut out all the noise; to concentrate on the work before him. The old-fashioned sign, "Don't talk to the bookkeeper," is a thing of the past. If the accountant were to display a sign, "Don't talk to the accountant," he would become the laughing stock of those about him. He is expected to work if necessary in a place where there is nothing but confusion; people

talking to him; people bringing books to him and taking books away from him. He may be in the act of footing a column of figures when someone comes to take the book away. Consequently he must learn to accommodate himself to circumstances.

How to Begin an Audit

CHAPTER VII

Counting the Cash

The preliminaries over, attention should be devoted to counting the cash, notes receivable, and the securities. These should be counted at once because of the fact that they may move. The make-up of cash to-day will probably not be the make-up of the cash to-morrow. Securities on hand to-day may not be the same to-morrow.

Having included in the outfit of supplies a quantity of journal paper, a sheet or more of same will probably be found best adapted to recording the count of the cash. The sheet should be headed up, showing at the top the name of the client or the name of the organization whose cash is being counted, together with the address of same, the date and hour of the count and the name of the person who has the custody of the cash. It is probably preferable to allow the person who is in charge of the cash to handle same. There are two reasons for this. One is that the auditor is not as a rule skilled in the handling of cash. A man who is handling it all the time can count it very much faster and with more accuracy than a man who counts cash once in a while. Such a man is liable to be clumsy and more apt to make a mistake than the other man. The other reason is that if the auditor does not handle the cash himself there is no possibility of his becoming involved in any irregularity. He may thus avoid becoming a victim of a sharp trick. Cashiers have been known where irregularities exist to attempt to put a part of it at least on the auditor who counted the cash. If the auditor does not touch the money he will not be involved in any such altercation.

The cash should be listed on a sheet of journal paper showing separately the bills according to denominations as well as the total amount of bills; the gold by denominations showing the total and the silver by denominations showing the total. Any I. O. U.'s, checks or vouchers, should be listed and full particulars given. A check mark of some kind should be placed on these papers individually, to indicate that they have once been seen and to prevent any question from arising later as to whether

or not such is the case. Here, again, the auditor may be the victim of sharp practice through papers being substituted after the cash has been counted. It is not necessary to make an elaborate check mark which will deface the papers or annoy the person who is responsible for them. A small double tick is equally satisfactory in every respect.

While on the subject of checking it might be desirable to insert a word of caution about marking up the books and papers of a client. The auditor has no right to deface, mutilate or destroy the records of the client because he has the right to examine them. A bookkeeper or clerk who has been neat and careful in his work, resents having its appearance spoiled by the auditor.

Care should be exercised in putting down everything in the way of information connected with the count of the cash. This is important because one never knows under what circumstances the information may be needed. If it is put down on paper it may be carried away and will be available in the future. The accountant might, for example, count certain cash in Waco, Texas, on one date and be obliged to discuss the cash account a month hence in New York with some officer of the company. It would be embarrassing under such circumstances, not to have all the facts, and be obliged to communicate with the office in Texas concerning the matter.

Having totaled up the sheet on which the cash account appears, the total according to the account should be compared with the balance in the cash book; the debit and credit footings put in the cash book in ink by the auditor; a line drawn above and below the respective footings; the initials of the auditor with the date placed alongside of each footing and the balance noted in the explanation column on the debit side of the cash book in ink.

If there is any difference between the cash as counted and the balance called for by the cash book, the person handling the cash should be given an opportunity to explain it or run it down. The most honest cashier that ever lived may, under the strain of having his cash counted, exhibit signs of nervousness. He may count two bills as one as they stick together. In listing some of the papers he may skip one or fail to put it down. If the auditor is handling and listing the papers, he may make

some error. It is not necessary to accuse a man of being short until he has had an opportunity to look over the accounts. It is not necessary to accuse a cashier of crookedness if he is out of balance only to a small extent, which difference undoubtedly signifies carelessness rather than dishonesty. If the discrepancy is sufficiently large, even though it is straightened out by the cashier, the fact should be brought immediately to the attention of the proper person. The matter should not be left for two or three weeks when it may be made the subject of argument. The auditor should go immediately to the proper person, who may be, depending upon the circumstances, the office manager, the treasurer, or perhaps the president of the company, and make the facts known. The question is sometimes asked, "If a cashier is short and puts in the amount of shortage, should it be reported?" The answer is that it depends on circumstances. It is quite evident that a man may be 50 cents, 73 cents, perhaps $2.00 or even $5.00 out of balance and willing to put in the amount of the discrepancy. Under such circumstances it is not probable that the matter would be worth reporting. Such a condition will probably indicate carelessness or unfortunate inaccuracy and nothing more. If, however, that condition is found repeatedly in counting the cash from month to month, the indications are that such person, altho not dishonest, is not sufficiently careful and accurate to be entrusted with the handling of the cash. It should be a matter of pride on the part of cashiers that they balance to a cent. Constant shortages increasing perhaps in amount may excite suspicion of dishonesty which is well founded. Tellers in banks are perhaps an exception to the rule that cash should balance to a penny. On account of the great volume of business handled by receiving and paying tellers, it is not unusual for mistakes to occur and discrepancies to result. This is a well recognized situation and is usually allowed and provided for in an "over and short" account. In fact, in some of the large banks the clerks and tellers are not held at night for a balance if the discrepancy is less than $50.00.

All the cash should be counted. It does not matter if the cashier insists that a certain envelope with money in it does not belong in his cash, it should be counted anyway. The amount need not necessarily be included in the regular count of the cash, but the amount involved should be jotted down on a paper

so that a record will be had of it in case it is needed later. It is probably not going too far to say to the novice, look through all the drawers or compartments of the cash box or till and see that everything is presented for verification. It is sometimes desirable to look through the compartments in the safe where cash is sometimes kept in order to be sure that nothing escapes attention. Some authorities hold that small amounts of cash need not be counted. The author's feeling in the matter is that all cash, no matter how small in amount, should be counted, if for no other reason than the moral effect which the procedure has.

The auditor should not accept without visual examination, canvas bags said to contain silver. He should insist that the bags be opened so that he may assure himself of the contents and proceed to have it counted or count it himself. Where the quantity is extensive, as in the case of banks or trust companies, it is possible frequently to save considerable time by taking the money to some neighboring bank and have it put through a machine for counting money. Some of these machines merely count the money while others count it and put it up in packages. The auditor may save the man who follows him on the engagement, considerable time, if after counting the small change, he puts it into a bag and places a seal with his certificate on the bag. The succeeding auditor upon finding that the seals have not been broken will then be relieved of the necessity of counting the money again.

Gold may be weighed. While ordinarily very little gold is encountered in making a cash count, there will be times, as in the case of banks where great quantities of gold will be found. If the auditor will count a thousand dollars worth of gold and weigh it, he will then have a basis upon which to calculate the total amount of the gold involved. This method is generally satisfactory, as gold runs fairly true to weight. The variation on account of coins which have become worn more than usual is negligible. Having weighed a thousand dollars worth, the balance may then be weighed and the weight translated into terms of dollars.

In some organizations there will be a general cashier who will have a general petty cash fund, and who will in turn, distribute smaller amounts to other employes. This is especially

apt to be true in hotels. The men behind the desk where the guests go to register are known as front desk clerks. These clerks usually act as cashiers and have their individual cash funds. In addition there will be funds in the possession of the cashiers at the bar, cigar counter and in the restaurant. It is always advisable to make inquiry in the beginning before starting to count the cash whether there are any funds other than those held by the general cashier. It is sometimes embarrassing to proceed with the audit and find petty disbursements coming in from one source or another and upon inquiry to discover that there are a number of individuals throughout the organization who have petty cash funds. If the question had been asked in the beginning and the cash all counted at one time, there would not have been any possibility of one party passing money to another to make up shortages. When the cash count is started it should be completed as soon as possible so that one employe will not have an opportunity to pass the word along to another, or perhaps furnish him with enough to make up the shortage. When counting the cash of two individuals who are in close proximity one to the other, both individuals should be kept constantly in sight by the auditor so that no assistance in the way of supplying cash may be rendered one to the other.

It is preferable if possible, that the cash be counted on the last day of the period which the audit covers. This remark applies with equal force to notes and securities. If the fact that an audit is to be made for the year ending June 30 is known some time prior to June 30 it is well to arrange to count the cash on June 30 if possible. This, of course, cannot always be done because of the fact that many times it is not known that an audit will be made until long after the period has closed. A client may not decide to have the accounts audited until after the close of the fiscal year. In such a case the next best thing may be done, namely, count the cash and securities immediately, or do it the first thing upon taking up the work. After the count has been finished and the balance compared with the balance in the cash book, the balance should be "worked back" to the date on which the period covered by the audit closed.

The illustration which follows attempts to present a sheet of journal paper showing the manner in which the record of the cash count appears.

(2) The Warburton Desk Company A.Lead
265 Broadway, New York

Cash count - Feb. 12, 1915 - 2 P.M. - E. J. Rockwell, cashier

Bills:		
$20	$ 500.-	
10	600.-	
5	400.-	
2	20.-	
1	760.-	$ 2270.-
Gold:		
$20	$ 100.-	
10	50.-	
5	40.-	190.-
Silver:		
$1.00	$ 2.-	
.50	35.50	
.25	17.25	
.10	12.30	
.05	8.25	
.01	17	75.97
		$ 2535.97
I.O.U.'s:		
Jan. 21, 1915 - J. B. Stevens	$ 20.-	
Oct. 12, 1914 - H. E. Band	10.-	
Checks:		
Jan. 17, 1915 - G. D. Gill #27	35.-	
Jan. 15, 1915 - C. E. Harvey #142	25.-	90.-
Vouchers:		
Jan. 14, 1915 - American Express Co.	$ .25	
Jan. 15, 1915 - J. Grimm	2.-	2.25
Total		$ 2628.22
Balance per cash book page 263		
Feb. 12, 1915		$ 2628.22
Add - Disbursements Jan. 1 to Feb. 12		5785.23
		$ 8413.45
Deduct - Receipts Jan. 1 to Feb. 12		5632.94
Balance per cash book page 257		
Dec. 31, 1914		$ 2780.51

Record of Cash Count

In the foregoing illustration Mr. Rockwell is the name of the man who handles the cash, that is, the man who is responsible for it; the cashier or the man whose cash was counted. The count shows silver dollars, altho not very many. Silver dollars are not numerous in the North and East, but in the South and West are frequently encountered in large quantities. The reason for segregating the money according to denominations is that an error may be easily located if it exists. Suppose for example, the cash were $10.00 out and the count had not been kept separately according to denominations. In attempting to discover the error it would be necessary to count all the money. Where the bills, gold and silver are kept separately and each class of denominations is shown separately, recounting the ten-dollar bills or the ten-dollar gold pieces may lead quickly to the discovery of the error, in which case, it will not be necessary to recount further. Concerning the I. O. U.'s and checks it is important that the date as well as the name of the maker and amount should be set down. The I. O. U.'s and checks which have been in the cash for any considerable length of time will naturally call for explanation. It is not necessary for the auditor at this time to express any opinion as to these items. He should, however, at the time when they are before him make a complete record of them and set down any explanation concerning them which may be made to him while the explanation is fresh in his mind. The vouchers shown will probably be receipts for small amounts which have been paid out by the cashier and for which at the time of the count he has not yet received reimbursement or has not turned in.

The result of the cash count as per the foregoing illustration is shown to be $2,628.22. The count was made on July 17, 1914. The balance shown by the count should agree with the balance in the cash book on July 17, at the hour when the count was made. In order that this may be so it will, of course, be necessary that all items of receipts and disbursements shall have been entered by the cashier up to that time. It may be found that the cashier has not had an opportunity to enter all receipts and disbursements, in which case such opportunity should be afforded in order that the proper balance may be struck and the balance agreed with the count.

Assuming that the balance in the cash book has been agreed

with the count, the following tabulation shows what is meant by working back the cash:

February 12, 1915, balance per cash book, p. 263......	$2,628.22
Add disbursements, January 2 to February 12........	5,785.13
	$8,413.35
Deduct receipts, January 2 to February 12...........	5,632.94
Balance December 31, per cash book, p. 257..........	$2,780.41

If any difficulty is experienced in understanding this tabulation, the items may be reversed, when the procedure will probably be seen at once. The vouchers and figures as they appeared in the cash book were as follows:

Balance, December 31..............................	$2,780.41
Receipts, January 2 to February 12.................	5,632.94
	$8,413.35
Disbursements, January 2 to February 12............	5,785.13
Balance, February 12..............................	$2,628.22

It should be noted that the real figure with which the auditor is concerned ultimately is the balance of December 31. It is that he has been trying to prove. Since he was not able to count the cash on that date he has availed himself of the first opportunity and used the intervening transactions as a means of checking the amount which it is claimed was on hand on December 31. The figures as shown by the cash book covering these intervening transactions may be accepted for the present and the amounts of receipts and disbursements respectively determined by footing the items representing them in the cash book.

While the following suggestion may be a valuable one, it should be put into practice only with discretion. Cashiers whose funds were counted and found correct, have at times been found short when the cash was counted a second time. This procedure should not be set down as a general rule. It should only be put into practice when the auditor has reason to feel dissatisfied

with the first count. It is not always possible to confirm a suspicion when counting the cash the first time. It is not always diplomatic to suggest any irregularity even if the suspicion is present. It is not always tactful to show signs of dissatisfaction if the person whose cash is being counted does not perform in every way as absolute honesty dictates he should. In such cases, or where the auditor has any reason not to feel perfectly satisfied with the count or the conditions under which it was made, he may count the cash a second time during the audit or at the end of the engagement just before leaving.

CHAPTER VIII

Counting the Notes and Securities

After having finished counting the cash the notes receivable should be taken up and counted. Notes receivable are like cash and securities, in that they may move. For the purpose of recording these, analysis paper will probably be found more satisfactory than journal paper because of the need to spread out the information and classify it through the use of the columns on the paper. The sheet should be headed up with the name and address of the client or organization to which the notes belong. Each note should be examined and listed, setting down in each case the following information; date of the note, name of the maker, the amount, date of maturity and rate of interest. Some notes may not carry interest. If so, the fact should be noted. Failure to make a memorandum of this kind may cause the accountant to come to a false conclusion later on when accruing interest, and perhaps after he has left the office of the client, that he failed to set down the rate of interest on the note in question. If the memorandum is made at the time the note is examined such alarm will be avoided. Notes are made in two ways; one kind reads substantially, "I promise to pay John Smith one thousand dollars—60 days hence with interest at 6%." The other kind reads: "Sixty days after date I promise to pay John Smith one thousand and ten dollars without interest." In consequence of such variation notes should be scrutinized very carefully.

As a memorandum the names of any indorsers appearing on the notes should be taken down. It sometimes happens that a concern will take a note from a corporation if the note bears the personal indorsement of some officer of the corporation, when it would not accept the note otherwise. A count of notes in a certain case recently revealed just that situation. The notes were those of a corporation not at all well known, but in which a prominent inventor was interested financially. It had been the custom of the client to accept notes from the corporation in question only in case they were indorsed by a well-known individual. One or two notes out of some nine or ten had come through

which had not borne the usual indorsement, had passed the cashier and been filed away without the oversight having been noticed. The absence of the indorsement was discovered by the auditor in examining the notes. It was quite important that the exception to the rule should have been noted and the attention of the client called to the fact that he had in his possession one or two pieces of paper not as strong as the others, or at least not as strong as he desired to have them.

The auditor will have occasion at some subsequent time either to calculate or check the accrued interest. On this account it is extremely important that all facts concerning the notes and interest be made a matter of record in his working papers so that such work may be done at any time, even after he has left the office of the client. He should put some mark of identification on the notes when they are counted, in order that others may not be substituted and that he will be fortified in case a dispute of any kind arises and it becomes necessary for him to state specifically just what he saw and counted.

Securities embrace, generally speaking, stocks, and bonds, and bonds and mortgages. Analysis paper is more convenient for listing securities than journal paper. Such should be headed up with the name and address of the organization and a description of the contents of the sheets; also the date that the securities were counted and the hour. Stocks may be considered first. The stock certificates should be examined to see that they stand in the name of the organization whose accounts are being examined, or are indorsed in blank. It sometimes happens in close corporations, where the stock is perhaps all held by one individual, except such shares as are necessary to qualify directors, that stock certificates will appear in the name of the principal individual concerned. The stock that is owned by a corporation should appear in the name of the corporation, or if the stock happens to be in the name of the individual, it should either be transferred or assigned in blank.

The list should show with regard to each kind of stock held—the name of the company that issued it, the number of shares or the kind of shares (preferred or common), the par value of each share, the par value of the block of shares held, and whether or not the stock is fully paid and non-assessable.

Care should be exercised with regard to stock on which in-

stalments have been paid. A certificate will now and then be found which appears on casual observation to be a stock certificate for one thousand shares, par value $100, amounting at par to $100,000. If this certificate is examined carefully there will be found perhaps in one corner or on the margin a statement to the effect that 25%, or the first instalment only, has been paid. While this is an exception to the rule that stock should not be issued until paid for, it is nevertheless true especially where large amounts are concerned that stock certificates are issued with the indorsement as to the instalments thereon which have been paid. It will make considerable difference in trying to balance out the total of the list against the securities ledger, if in such cases, stock is listed as fully paid when in fact a percentage only has been paid.

In the case of bonds, analysis paper should be used for listing and the sheet headed up the same as for stocks. The list should show with regard to each kind of bonds held (after having been examined and counted) the name of the company which issued the bond, a complete and accurate description of each, par value of each bond, par value of the block of bonds and the date of maturity, the rate of interest and the dates on which the interest is payable. Each bond should be examined. If a registered bond, the examiner should see that the last payment of interest has been indorsed thereon. If a coupon bond, the coupon should be scrutinized to see that the next one coming due as well as all the succeeding coupons are attached and intact. Provision should also be made on the analysis paper, through appropriate columns, for the accrued interest and in some cases, for amortization and accumulation. It is not probable in a small organization where there are few investments and they are small in amount that amortization and accumulation would need to be considered. Where the reverse is true, they are matters of importance.

With regard to the accuracy of the description, a word or two should be said. There are at least two good reasons why the auditor should be particular about describing a bond accurately. Accuracy begets confidence. One can never tell when this information may be needed. There is no end of embarrassment when the information is not accurate. There is an equal amount of satisfaction when the information is accurate. In

attempting to verify the figure at which bonds are carried, reference is usually had to some publication like the *Financial and Commercial Chronicle* or the daily papers for the purpose of getting quotations. Whether or not the correct quotation is obtained will depend in certain instances on the description. For example, the Chicago, Milwaukee and St. Paul General 4's were issued in series. Series "A" will mature in 1952, series "B" in 1962, series "C" in 1972. In looking up the different quotations on these different series it will be found that they are quoted as follows: series "A"—78, series "B"—87, series "C"—93. It will be seen consequently that failure to note the series in a case of this kind will later make a difference of from ten to twenty points in the valuation.

The information concerning the rate of interest, the dates on which the interest is payable, etc., will be needed either in order to make or check the accruals of interest and to determine very often whether or not the interest has been properly treated. A bond may be bought at 102 and accrued interest and carried on the books at $1,035.27, for example. Three things in reality have been bought; a par value principal, a premium and some accrued interest. When the coupon is paid it will be based on the par value principal, but a part of the total of the coupon will be earned during the period. The interest should be divided into two parts. One part should be credited to the accrued interest and the other to interest earned. It is important that all facts concerning interest should be available in order that the treatment of the interest may be properly checked. This, for example, might involve ascertaining whether or not the whole amount of the coupon in such case had been credited to interest earned and the accrued interest which attached to the bond when it was purchased allowed to remain as an asset, or whether the amount of the coupon had been properly apportioned and treated.

Where bonds are found in which coupons have been detached inquiry should be made immediately to ascertain the reason. Such an inquiry should of course be tempered with judgment in case it is quite apparent that the coupons have been detached for collection. If such is the case, however, the coupon should be traced through and checked out.

It might also happen that bonds are out for the purpose of

being registered as to principal or interest. Where this is the case a memorandum should be made as to the particulars concerning them and they should be examined at some later date. It is always advisable that they be seen sooner or later, altho in some instances where litigation is going on they may be held by some trustee. In extreme cases it may be necessary to obtain from a trustee or the registrar a certificate to the effect that the bonds are being held.

Again in the case of bonds and mortgages analysis paper should be used for listing the documents. They should be examined and a record made of the date, the name of the maker, the amount, the date of maturity, the rate of interest and the dates on which the interest is payable, if specified. Two documents or instruments are involved, the bond which is the evidence of indebtedness and the mortgage which is the security for the bond. It is the bond which should be examined for the information just mentioned. The mortgage should be scrutinized to see how it is made, by and in whose favor and whether or not in favor of the client. If not so made it should be properly assigned. The examination should include verification of the fact that it was signed, witnessed and recorded.

In connection with the matter of record it sometimes happens that bonds and mortgages will at the time of counting the securities be out for the purpose of being recorded. In certain counties in New York, owing to the vast amount of work of this character, it sometimes requires a considerable length of time to have the record effected. Consequently in extreme cases it may be desirable to get a certificate from the county clerk to the effect that certain mortgages are being held for record.

Incident to the matter of record it is important that the auditor in examining the bonds and mortgages in New York should watch for mortgages recorded between July, 1905 and July, 1906, and be sure that the entire mortgage tax for such period has been paid. The tax on some mortgages executed during this period still remains partially unpaid.

Insurance policies on property covered by mortgages should be requested and inspected to see that the property is amply protected. A mortgage on a building would not be of much value if the building were to burn and not be protected by insurance. One who holds a mortgage usually sees to it that the

property is insured and usually insists that the insurance policy be filed with the person holding the mortgage.

Tax receipts should also be produced as evidence of the fact that the taxes have been paid up. Since a tax lien on property takes precedence over everything else it is highly important that the value of the property be not impaired in this respect.

Among miscellaneous securities, in addition to the three classes above discussed may be found certificates of indebtedness, certificates of deposit, warehouse receipts, scrip, receipts for payment on account of capital stock, subscriptions and evidences of syndicate participations. While these may not include everything with which the auditor may come in contact they are sufficiently indicative of what is meant by miscellaneous securities.

As a word of advice to the young and inexperienced auditor, it may be said that he is justified in taking as much time as he needs to properly read and interpret the miscellaneous documents above mentioned. He should not be afraid to take all the time necessary to read them through in order to find out what they are. He should not allow anybody to worry him or hurry him until he has satisfied himself in this particular. He is charged with the duty of passing judgment on such instruments and it is vital to him that he should not pass anything without knowing exactly what it is and being satisfied concerning it. He should never hesitate to take down all the facts and all the details which he thinks necessary. While tact is of course important, he should bear in mind that he is not counting the securities in order to accommodate the man in whose custody they may be found, but rather to verify the fact of their existence and propriety as an investment.

CHAPTER IX

Taking Off the Trial Balance

The preliminary work having been completed possibly the next thing to be done is to have the pass book sent out to be balanced. It will sometimes happen that the pass books have recently been balanced and the persons concerned in sending them out will hesitate to do so. The auditor should, it seems, insist on having them sent again if necessary. While this procedure is not absolute proof against collusion, it tends to prevent it and to discover it if it exists. It is not considered sufficient as a rule to accept the balance shown in a pass book even after it has been balanced a second time, for the reason that there may have been collusion between some clerk in the bank and some employe of the company. In addition to having the pass book balanced, a certificate signed by some proper officer of the bank, setting forth the amount of the balance should be obtained. The auditor will be called upon either to write a letter to the bank requesting a certificate, or to send out a form letter containing the request. The request in either case should have the approval of the client before being sent to the bank. The bank should be asked to return the certificate to the auditor direct and not through the client or his office. It is important that the letter should be approved by the client since it is not customary for banks to furnish information concerning balances of depositors upon request without the approval of the depositor. The question has sometimes arisen as to whether or not banks have the right to give out such information without the permission of the depositor. Banks have frequently held that such information is confidential and have refused to divulge the condition of a despositor's account without a court order. Specimens of the letter and blank form above mentioned will be found below.

Jones and Parker,
Certified Public Accountants,
32 Waverly Place,
New York City.

February 12, 1915.

Second National Bank,
Fifth Avenue and 27th Street,
New York City.

Gentlemen:

In connection with our examination of the accounts of the Warburton Desk Company, we are desirous of verifying the amount on deposit with you to the credit of said company at the close of business on February 12, 1915.

Will you oblige us therefore by sending your certificate to our office at the above address?

Yours very truly,

(Signed) Jones and Parker,
Certified Public Accountants.

Approved:

....

A letter such as the above would probably be used by an accountant with a small business or dealing with small concerns. Many of the larger firms of accountants deal with large organizations which have numerous bank accounts. It is not unusual for railroads to have from forty to fifty such accounts. Where there is occasion to request a great many certificates, the auditors frequently avail themselves of a blank form. This form is perforated, the upper part being a letter addressed to the bank while the lower part is a certificate to be filled out by the bank.

HASKINS & SELLS
CERTIFIED PUBLIC ACCOUNTANTS
30 BROAD STREET
NEW YORK

CABLE ADDRESS "HASKSELLS"

WATERTOWN
BALTIMORE
PITTSBURGH
CLEVELAND
CHICAGO
ST LOUIS
ATLANTA
DENVER
SAN FRANCISCO
LONDON, E. C.

New York, February 12, 1915.

Dear Sirs:

Please complete and mail to us, in the accompanying stamped and addressed envelope, the attached certification in respect of The Warburton Desk Company for which we extend our thanks in anticipation of your prompt attention.

APPROVED

Yours very truly,

COPYABLE

Messrs. Haskins & Sells,
Certified Public Accountants

No. 1

Dear Sirs:

At the close of business on February 12, 1915, the balance on our books to the credit (Credit or Debit) of The Warburton Desk Company was Four thousand three hundred twenty-seven and 58/100 Dollars ($ 4,327.58)

In the period from December 31, 1914, to February 12, 1915, inclusive, we credited or paid said The Warburton Desk Company interest to the total amount of none Dollars ($ none)

At the close of business on February 12, 1915, said The Warburton Desk Company was obligated or indebted to us on loans, notes, participations, or other accounts or contracts, as follows:

None

Dated at ____________________

____________________ 191__.

By ____________________

(Title) ____________________

It will be noted in connection with this form that there are certain inquiries made other than that contained in the first letter above mentioned. Small organizations are not so apt to have complicated relations with banks as larger ones. Getting certificates from a bank very often, however, uncovers matters not disclosed by the client or his employes. The author recently had occasion to request a certificate from a certain bank and took the letter personally to the manager of the branch where the account was located. On presenting the letter he was asked which account he desired. He promptly replied that he wished to know the balances of all the accounts. He received balances of three accounts instead of one, the two additional accounts being special ones which had been concealed.

In a similar manner the above form letter may develop the existence of additional accounts of loans and interest which may affect the situation.

Banks, as a rule, are very accommodating in the matter of furnishing certificates. They sometimes object, however, to giving the details of interest credited to the account, except such interest as may have been credited since the pass book was last balanced. Some banks which render a statement every month in which the interest is included, ignore the matter of interest entirely in so far as a certificate is concerned, since they feel that the monthly statement which they render should furnish sufficient verification for the auditor.

The matter of having the pass books balanced, out of the way, attention may be devoted to the taking off of the trial balance. Before that is discussed, however, a word or two may be said relative to making a list of the books. Some accountants advocate getting a list of all the books used by the client before proceeding with the work. Other accountants ridicule the idea. Making such a list may be scientific procedure. On the other hand, doing so may give the impression that the auditor is inexperienced and attempting to follow some set of rules in doing the work. The auditor who understands his business should be familiar with all the books generally used. If it so happens that the peculiarities of certain lines of business require special and unusual books, the fact will become apparent during the course of the audit and should occasion no embarrassment if the auditor is sufficiently self-possessed to ascertain the function of the

book or form even though it is unfamiliar to him. Professional pride is a very worthy attribute. It should not, however, be allowed to stand in the way of getting information. It is no reflection on an auditor that he is not familiar with every book and form which exists. There is no reason why he should hesitate to confess this fact. Consequently there is no reason why he should not be perfectly frank in asking about any book or form which he does not understand. It seems therefore that it is not necessary and perhaps undesirable on account of the impression that it may make, to prepare a formal list of the books. This argument is not against so doing in the case of an engagement where the man in charge desires to be systematic in planning the work of himself and his assistants and makes a memorandum list as an aid in laying out the work.

By this time the auditor will probably be ready to take a trial balance of the general ledger. The general ledger is the key to the whole situation. Everything is supposed to be summarized therein. If an auditor were to begin with the ends and work toward the center, it is probable he would find some difficulty in tying up his results. It is customary to begin with the control which the general ledger is presumed to present, and work from that as a basis.

Whether the auditor should take the trial balance of the general ledger himself or accept one which has been prepared and furnished to him, is perhaps a question. Tact will probably dictate that he accept such trial balance if offered to him. There is no occasion for hurting a person's feelings by refusing to consider such an offer of assistance. The author is strongly in favor of having the auditor take his own trial balance. Not because of the fact that he is suspicious of the one offered to him, or too proud to admit that the bookkeeper is not competent to take a good trial balance, but because of the fact that it offers an opportunity to the auditor to familiarize himself with the business and its transactions. He cannot help, in going over the accounts one by one, thinking about them and in being obliged to spend the necessary time on each account in order to take the balance off, build up in his mind as he goes along, a general idea regarding the organization as a whole together with its different ramifications and functions. This is not only true of the first time which he handles the engagement but any repetition

of same. The act of taking off the trial balance even on repetition of the engagement, gives him an opportunity to refresh his memory.

It might be well here to say that the books are not ready to be audited if they are not in balance. The auditor should not proceed with the work if the books are not in balance until he has discussed the matter with the proper party and had an understanding as to what he is to do. As a theoretical matter, at least, auditing is not accounting, and if the auditor is obliged to finish writing up the books, make entries, hunt out errors and put books in balance, he is doing bookkeeping or accounting work and not auditing. As a practical proposition, doing such work, unless specifically agreed to, is apt to result to his prejudice. If the work is being done under a contract, and the time necessary to do the work has been estimated, putting in a lot of time finding mistakes in bookkeeping, is apt to result in a loss on the engagement. If the work is being done on a per diem basis, the auditor is apt to become involved in a disagreeable discussion with the client because of the fact that time has been spent in doing work which should have been done by the employes of the client. If a situation, such as the one above suggested arises, it should be brought to the attention of the proper authority immediately without proceeding with the work and the client's wishes in the matter ascertained. While this may delay the engagement somewhat, it will be found more satisfactory in the end.

In taking off the trial balance two sheets of analysis paper should be used. Each sheet should be headed up with the name of the organization and marked "trial balance, general ledger before or after closing," as the case may be, with the date. One sheet should be used for the debits and one for the credits. The sheets should be so arranged that the first column of each will be used for the ledger folio, the second and third columns for the titles of the accounts, the fourth column for references, the fifth column for amounts. This arrangement provides for the beginning of a working sheet, so that the columns to the right of the fifth may be used respectively for the debit and credit adjustments and the final balance sheet and income statement figures. This will leave three columns (if 12 column paper is used) for notations on accounts which do not require extensive analysis.

If more than one sheet is required, either in the case of debits or credits, the sheets should be numbered with a separate series for debits and credits in the upper right hand corner. In the majority of cases there will be more debits than credits. These perhaps are small matters, but it is a knowledge of these little things and attention to them which may make the difference between success and failure in the case of the young man starting in. Too many accountants are apt to forget the fact that someone else at a later date may have occasion to use the same working papers. There is nothing more annoying than to go back into old working papers and be unable to get any information from them without spending hours in digging it out. On the other hand, there is nothing more satisfactory than to refer to old papers and find them not only full of comprehensive information but so arranged and labeled that the information may be obtained quickly. A folder of working papers may contain a number of trial balances. If they are not properly labeled and described they are apt to be of little value and to cause great annoyance to the person referring to them. If the trial balance is not properly labeled and becomes lost from the folder, there may be no way of getting it back to its proper place even if it happens to be found.

Another minor point which the young man should keep in mind, is that he should always write his name on all papers which he makes. Seniors have been frequently heard to utter words which are unprintable because in going over working papers they were not able to discover who did the work. Papers which are not clear in themselves may frequently be cleared up by getting in touch with the man who made them. If it is impossible to find out who did the work there is little possibility of clearing up the points in question. Attention to these little matters on the part of the junior frequently engenders a feeling in favor of such a man. In fact, his continuation on the staff at the time when men are being dropped on account of lack of work may depend on just such little things as these. Many times a senior is asked when starting out on an engagement, which men he wishes to assist him. Knowing the men who are available he goes over them mentally one by one. In the decision the man who is careless about details, a poor writer, or slovenly in his work, is apt to be eliminated. A man who

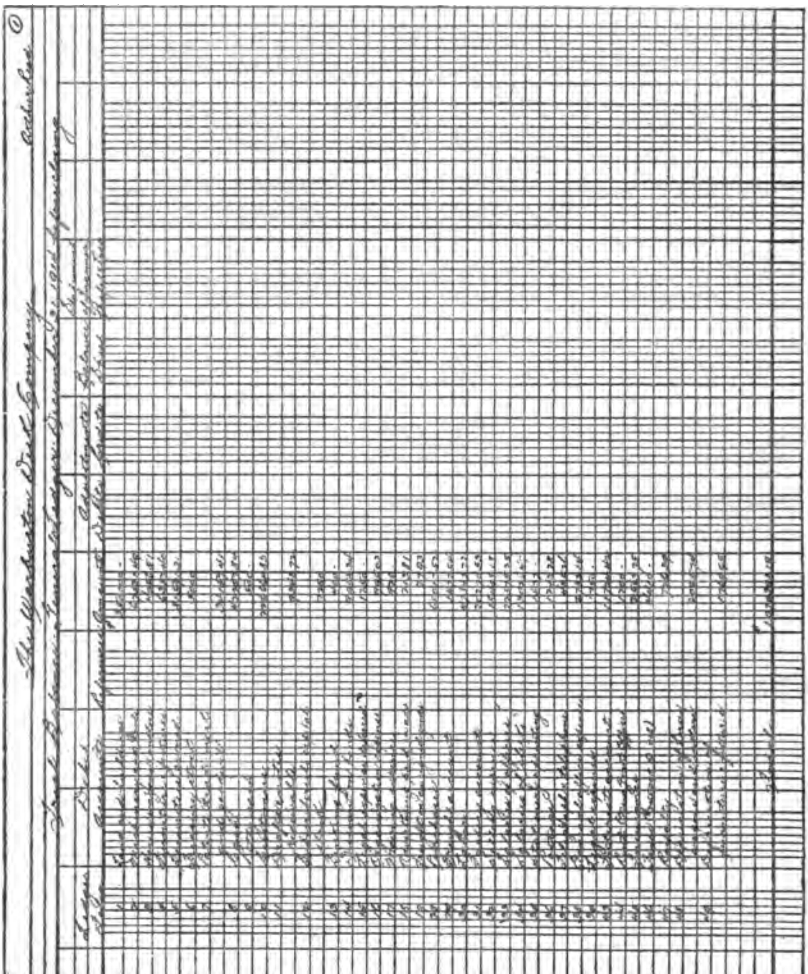
is careful about everything, and dependable, and a man who is known to produce finished work, is apt to get the call. Being repeatedly chosen under such circumstances tends to serve as a recommendation and to make a favorable impression upon the office manager or member of the firm. Being constantly refused or criticised tends to produce the opposite impression.

On taking off the trial balance, each item should be proved by deducting the footings in the respective accounts one from the other, instead of taking the balance for granted because it has been jotted down in pencil in the ledger. What appears from a pencil notation to be the correct balance may, in fact, be an old one. Its inclusion in the trial balance may produce an incorrect result. The ledger should be paged through to the end. That is to say, each page should be turned over and examined. This procedure should be carried through to the end of the book. The auditor sometimes has difficulty in getting a trial balance because of the fact that one or more amounts have been omitted. Sometimes a bookkeeper for one reason or another will run the accounts along page after page and then suddenly skip a number of pages and go on. Sometimes most of the accounts will be shown page after page beginning at the front of the book with the profit and loss account or the surplus account or the proprietors' account on the last page of the book. There is no accounting for the manner in which the minds of some bookkeepers work. There is no accounting for some of the things which they do. The auditor must therefore, in taking off a trial balance, guard against the idiosyncrasies of bookkeepers.

Following out the thought above suggested, subsidiary accounts will sometimes be found in the general ledger mixed in with the general ledger account. Sometimes memorandum accounts which have no place in the classification will appear. Customers' and creditors' detailed accounts as well as the controlling accounts therefor are put into the general ledger because there is room for them. All these things have to be kept in mind and guarded against.

Another thing which should be remembered is that the trial balance should contain a cash account. Someone, for some reason or other, launched the theory a few years ago that if a cash book was used it was not necessary to have a cash account in the general ledger. It would be just as sensible to say that

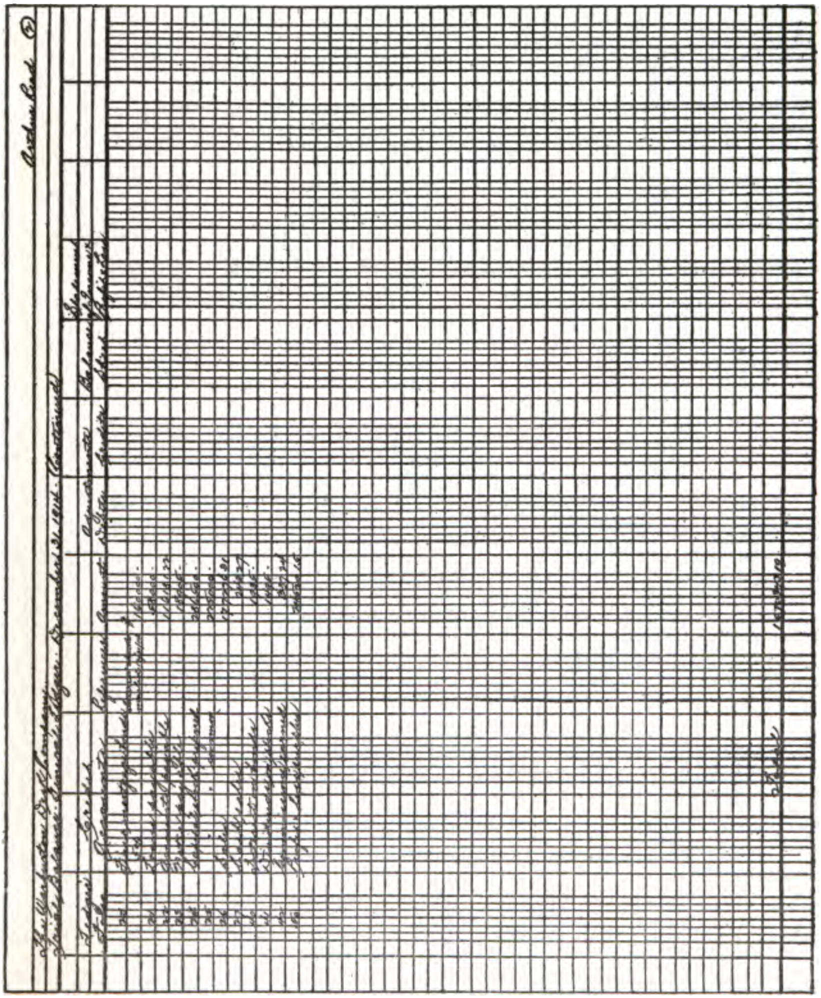
because a customer's ledger is used it is not necessary to have a customer's controlling account in the general ledger. Likewise, it might be contended because there is a book for notes receivable in which they are entered when they are received and a line drawn through them as they are paid, it would not be necessary to have an account for notes receivable in the general ledger. The balances taken from the general ledger should yield a trial balance of accounts. All other information necessary to a



trial balance should be included therein, not excepting the cash account. Anyone who favors good practice should not permit an argument on this point.

The illustrations will show how the trial balance would appear on the analysis sheet at this point, and also offer in a way, the suggested outline which the discussion will follow.

It is to be understood that the items appearing in the trial balance are such as might appear in any ordinary case. The



classification of accounts shown therein is not ideal or exhaustive by any means. It presents a typical case and, in fact, offers a better opportunity for study than an ideal classification.

A word in explanation of the working sheet and its operation as used by the auditor may not be amiss at this point. The trial balance according to the ledger, represents the figures as shown by the bookkeeper. Whatever errors are discovered during the audit will require adjustment in the auditor's report. In other words, if there is a difference between the figures shown by the bookkeeper and the correct figures, the auditor will present the correct figures. It is important that the auditor shall be able to explain the difference and to establish the connection between the figures as reported by him and the figures shown in the books, if necessary. It is the working sheet which offers an ideal opportunity for this very thing. If the auditor will make for his own papers, memorandum journal entries covering the errors discovered, or any adjustments which may be necessary, and will on the working sheet, post these journal entries in the adjustment column, he will then be able, by applying these debits and credits in the adjustment columns to the figures in the trial balance column, to arrive at the correct results, which may then be distributed into the balance sheet and income statement columns. In this way the connection between one set of figures and the other is clearly established and explained. The memorandum journal entries just referred to may be attached to the trial balance in support of the figures in the adjustment columns. It will be apparent at any future time and to anyone subsequently taking up the matter, exactly what happened. The auditor will also have the correct and final figures from which to prepare his report.

What to Do During an Audit

CHAPTER X

Reading the Minutes

The precise order which should be followed in making an audit is a matter which is perhaps open to discussion. It depends very much on personal choice. Reading the minutes immediately after having completed the trial balance, seems to be the next logical step, however. The reading of the minutes gives one an insight into the organization; it prepares one to do intelligent work; it suggests whom to consult in case any information is needed; and in short, it enables one to size up the whole situation before going further with the work.

In the case of a corporation, the minutes of the stockholders, the minutes of the directors, or executive committee, or any special committees should be read. The auditor should also ask for the contract filed or copies of any contracts which are in existence.

On a sheet of journal paper he should make an abstract from the minutes of the stockholders. He should do likewise in the case of the other minutes above mentioned. If the certificate of incorporation is not embodied in the minutes of the stockholders, he should ask to see a copy of the articles of incorporation or a certificate of incorporation. These words are used interchangeably at times. The articles of incorporation are also referred to as the charter. The charter should be examined if a copy is available, or if not, a certificate executed by the secretary of state. There should be jotted down on the journal paper, the exact name of the corporation, the date the certificate was filed, the authorized capital stock showing the par value and the kind of stock if there is more than one class, and the par value of each share. There should also be noted the names of the incorporators, and it may be important to make a note of whether or not directors must be stockholders. All these little matters may become necessary in writing the comments. If such occasion presents itself it is well to have all the facts at hand. It would be very embarrassing for an auditor who had done a piece of work in Arizona to be back in New York and wish to know the date on which a certificate of incorporation was filed

if he did not have the information. There are certain things which in writing comments must be said with exactness. If it is necessary to give the date on which a corporation came into existence, it is the exact date and nothing else which is required. To say about January 7 or about January 9 is not sufficient. The auditor is expected to be accurate.

Glancing through the by-laws will show the powers and duties of the officers. While the information may be superfluous to many, it is possible that certain readers will find it helpful to have recorded here the general duties of the officers. The president is ordinarily required to preside at meetings of stockholders and directors, to present a report at the annual meeting, to appoint and remove, employ and discharge, and fix the compensation for all servants and agents, employes and clerks, sign all contracts and agreements, all certificates of stock, countersign the checks, notes, drafts, warrants or other orders for the payment of money. The vice-president usually performs these duties in the absence of the president, and in addition any duties which may be assigned or delegated to him. In large organizations where there are several vice-presidents, one may have charge of the purchasing, for example, whereas another has charge of the sales. The secretary keeps the minutes, serves notices, has the custody of the records and seals, keeps the stock and transfer books, attends to the correspondence and lays matters before the directors at the request of the president or shareholders. The treasurer has the care and custody of funds and securities. He has the power to sign, make or endorse in the name of the company, all checks, notes, drafts or warrants for payment of money, sign all certificates of stock and render financial statements. This latter would probably be true only in the case of companies which do not have a comptroller. It is usually the duty of the comptroller, where such office is provided for, to prepare and render the financial statements. The by-laws will usually contain a provision concerning the bond of the treasurer. The minutes should also be scrutinized for any action taken by the stockholders in the matter of authorizing the issue of bonds or placing mortgages on the property, or ratifying the action of the directors in so doing. In certain states mortgages may not be placed on company property until approved or ratified by two-thirds of the stockholders.

As a practical matter it would perhaps be wise to note the date of the annual meeting in order that the auditor may have in mind if he does not already know, the time at which his report will probably have to be in the hands of the company. Sometimes it is necessary to get the report in so that it may be printed and placed before the stockholders at the annual meeting. Further notation might be made of the compensation of directors and as a matter of curiosity perhaps, whether an auditing committee is provided for, and if so, what the duties of the members are. As a matter of fact, the auditing committee sometimes employs an accountant to do the work and make the report to the committee.

The minutes of the stockholders should be examined with regard to the election of officers, the compensation of officers, extra compensation, bond of the treasurer, depositary or depositaries, contracts with manager, contracts for the purchase of a business, resolutions fixing the value of property purchased and the rates of depreciation, etc. There may also be found in the minutes of the directors, provisions concerning the bonds of employes other than the treasurer, altho as a rule such matters are left to the president with power to fix the amount of such bonds.

The executive committee consists, as a rule, of three members. It is simply a small committee from among the directors for the purpose of facilitating certain features of the work. The financial side of the concern is usually looked after by the executive committee. This committee often outlines the financial program and makes appropriations, etc.

The auditor should examine co-partnership agreements, joint venture agreements, operating or selling contracts, and in each instance make an abstract showing the date, parties to the contract, period to be covered and the substance of it. If at all probable that the information may be needed later on, important parts of the contract should be copied word for word. No time will be wasted in thoroughness in this particular. It would be preferable to spend an hour or half a day if necessary copying something that might never be of any use, rather than to fail to get information which might be vital in the future to litigation. This precaution is especially desirable in out of town engagements. It may possibly be of interest to have presented a

practical illustration of what one might come in contact with in reading over minutes. The illustration is taken from the working papers of an engagement in the New York University division of applied accounting. It is an abstract of the minutes of the executive board of a certain organization, the name of which as it appears being fictitious, relative to operations for the year ended September 30, 1914. In this organization the governing board instead of being the board of directors or board of trustees was called the executive board.

The National Aid Association

Abstract of minutes of Executive Board
for the year ended December 31, 1914

Meeting January 15, 1914.
"That the treasurer be empowered to advance a sum not greater than $500.00 to finance an athletic carnival to be given in behalf of the Summer Camp, the amount so advanced to be returned to the association."

Meeting March 15, 1914.
"That the treasurer be authorized to purchase a $1,000.00 Southern Pacific RR Co. bond for $900.00, and to deposit the sum of $100.00 in a savings bank, in order to establish a Special fund of $1,000.00, the income of which is to be applied for maintenance expense of the Summer Camp."

Meeting April 15, 1914.
"That the secretary be authorized to establish an "Educational Fund" through the consolidation of the following funds now on the books:

Scholarship fund	500 -
Library fund	1000 -
Fellowship fund	900 -
Total	$2400 -

Meeting June 15, 1914.
"That the secretary be authorized to increase the salaries of the following employees, effective July 1, 1914:

Bookkeeper	from	$90	to	$100	per month
Stenographer	"	65	"	75	" "
Office clerks (2)	"	45	"	50	" "

CHAPTER XI

THE MECHANICAL WORK

The work to be taken up next is what is sometimes referred to as the mechanical work. Mechanical work may be divided, generally speaking, into three classes—vouching, footing and checking postings. By vouching is meant checking entries from supporting papers. The entry appearing on the books is not accepted as being final and conclusive. Some further evidence or support is considered necessary.

The vouching will be found necessary in connection with the following books:

General cash book
Petty cash book
Purchase journal or voucher register
Purchase returns and allowances
Sales book
Sales returns and allowances

In addition there may also appear at times a payroll book. It is probable, however, that vouching in connection with payroll books is becoming less and less frequent. There was a time when it was customary to find a receipt for each employe on the payroll, that is, a receipt purporting to be signed by such employe. The reason for a payroll book is that too much room would be taken up in the general cash book if there were to be entered therein the names of all employes who received wages with the amounts received. The idea of a payroll book follows the idea which has been brought out before, namely, that certain classes of items have been withdrawn from the cash book in order to facilitate the work and avoid filling up page after page in the cash book with names and amounts. The payroll book is usually so arranged that the names are written once and by using a columnar book with short pages, the amounts are entered from month to month opposite the corresponding names. This has the effect of course of a special cash book for recording payments to employes where employes are numerous. Vouchers supporting such payments are not always satisfactory. This is apt

to be true in organizations where the number of employes is so great that many of them are not known personally to the cashier. The padding of payrolls and turning in of fictitious receipts is perhaps encouraged rather than prevented where receipts are accepted without any personal knowledge of the employe on the part of the cashier. A better and more satisfactory scheme consists in having a man who actually pays out the money to the individual, and who must be a trustworthy employe, initial the payroll book and perhaps give a voucher for the entire amount. The ideal scheme is to have the individual employe present himself at the office and receive the money from the cashier in the presence of a second party. This, however, in large plants where the employes are numerous results in a considerable waste of time and is frequently objected to as being uneconomical in this respect. Notwithstanding what has been said, payroll books are frequently found. The individual items are supported by signed receipts and a majority of them probably should be examined.

Footing will be applied to the following books as a rule:

General cash book
Petty cash book
Purchase journal or voucher register
Purchase returns and allowances
Sales books
Sales returns and allowances
Payroll book
General journal
General ledger accounts
Customer ledger accounts
Creditors ledger accounts

It may appear offhand that the ideal course to pursue will be to foot all these books. That this is not necessary will probably be apparent later on. As specific books are taken up in detail, it will probably be found that the footings may in many cases be dispensed with. It might seem ordinarily that because someone has made all these footings in order to prove them the same thing must be done. This will probably be found unnecessary in certain cases.

In the matter of checking postings the following books must be considered:

General ledger
 from
  General journal
  General cash book
  Petty cash book
  Purchase journal
  Sales journal

Customers' ledger
 from
  Sales journal
  Sales returns and allowances
  General cash book or (customers cash book)

Creditors ledger
 from
  Purchase journal
  Purchase returns and allowances
  General cash book

No attempt has been made here to indicate more than general procedure. It is planned to take up one by one and in detail these different processes. While it has been said that the customers' ledger should be checked from the sales book and the general cash, it may be found as a matter of fact when the customers' ledger is checked that the actual procedure will be just the reverse. The above arrangement is only intended to indicate the general relation of the books and the work in connection with them. Just as it is considered sufficient to do only a part of the vouching and footing, so it is usually considered sufficient if a certain proportion only of the postings are checked.

There should next be taken up the vouching of the cash book. Before, however, going into the detailed work of vouching, cash books in general, on account of the great variety they present, should be discussed. Cash books will vary in size, form and ruling. The number of varieties will be surprising. There

is one thing, however, upon which dependence may be placed and that is, the principle that a cash book should record cash receipts and disbursements no matter what its form, size or ruling. It is the function of a book always which must decide what the book is, regardless of what it is called or how it is constructed.

The volume of business may be sufficiently large so that the cash book will be divided into two parts, one for receipts and the other for disbursements. Suppose for example, that there are a great number of cash receipts and very few disbursements, or a great part of the cash receipts comes from customers. Instead of filling up the general cash book with all these details, there may be what amounts to a subsidiary book for cash receipts from customers showing with respect to each customer the amounts received. The total from this book will then be carried at the end of the day to the general cash book where one entry for customers will be made. On the other hand, there may be cases where the receipts will be large in amount but few in number, or the disbursements small in amount and great in number. Under such circumstances a number of books for disbursements may be needed from which the totals will be carried to the general cash book in which one entry only for the day will be made. In some general cash books where either one or the other of the above situations prevails, the total receipts and total disbursements will be shown so that the balance may be ascertained, or either the receipts or the disbursements may be split up into a number of different books for convenience. Books combining both receipts and disbursements, or showing either separately, may be alternated by days. One cash book may be used for the odd days and another for the even days. Such alternation is usually introduced in order to facilitate posting. While one is in use for the purpose of making entries, the other is being used for the purpose of posting details to customers' or creditors' accounts. Offices which are run twenty-four hours a day sometimes have a cash book for the day man and another for the night man. This is frequently found in hospitals and similar institutions. The day man when he goes off duty will turn his cash book over to the night man. The night man will post from the book during the night so that in the morning everything is posted up. For the purpose of con-

trolling the work of the individuals, the night man is compelled to keep his receipts and disbursements in a separate book as well as his cash in a separate box so that he can account for his balance and turn it over in the morning. These possibilities are mentioned in order to indicate the great variation and the possibility of combination which exists in practice. To find four or five different cash books in an office is not unusual.

Variations will also be found in the rulings. One kind will have two money value columns on the left-hand page and two similar columns on the right-hand page. This kind may perhaps be found in a bank or a broker's office. The kind which is probably met with most frequently is that in which the ruling is especially arranged in columns. Beginning on the left-hand page at the left side of the page there is the column for the date. This, going from left to right, is followed by a narrow column or columns for posting references, with subsequent columns for the name, explanation, net cash, discount, customers and general ledger items. The ruling on the right-hand page is precisely the same. The headings for the columns are the same except that the word "creditors" is substituted for "customers." A further variation of this idea consists in introducing two additional columns for bank deposits and withdrawals. This will be found with the deposits at the extreme right of the left-hand page and the withdrawals at the extreme left of the right-hand page. When the book is opened these two columns will appear in the center of the double page. Where there are more bank accounts than one, additional columns are introduced.

In an institution or an association, the accounts for which are run on a cash instead of an accrual basis, a cash book still different in ruling is liable to be found. Where a cash basis is used it is customary to find a considerable number of columns taking the place of the general ledger columns in order that the income and expense may be classified. Under this basis the income is apt to be in the form of cash receipts. The expense is liable to take the form of cash disbursements. This situation gives rise usually to a long book which may look very much like a purchase journal or voucher register. There are many cases in which a purchase journal is used where the accounts are kept in this way, but such a

situation really modifies the true cash basis and the principal purpose of the columnar cash book as just described is to provide for distribution.

It may not be amiss to reiterate that the form or arrangement of a cash book does not affect the function. Knowing what the function of the cash book is, it should not make any difference what physical means are employed for exercising the proper function. The function of the cash book is to show the receipts and disbursements of cash and the balance resulting therefrom. The work of auditing a cash book should consist in verifying the items which make up the receipts and the disbursements, not only in detail but in aggregate, and proving the balance by inspection of the cash in hand, or the certificate of the depositary or both. It is necessary to include both because of the fact that sometimes the balance in the cash book is all represented by cash in hand; sometimes by cash in hand and cash in bank. Sometimes the cash is all in one bank and sometimes in several.

Verification of the receipts may be first considered. This operation so far as the auditor is concerned, is not always as satisfactory as it might be. There is little hope of laying down rules which will be absolutely proof against exception. All one may hope to do is to indicate enough of the general principle involved, or to state rules of a general nature, so that the novice may exercise his ingenuity in applying the principles when he comes in contact with these things in practice. It is not probable that the young man will have as his first experience that of plunging into the audit of a municipality, a railroad, or a bank, alone. If his experience happened to be in the organization of any one of these three kinds, it would probably be under the supervision of someone else. What seems desirable, therefore, is to discuss the matter in its relation to the kind of organization with which the young man is most liable to come into contact in the earliest years of his experience. Such organizations are mercantile, manufacturing and trading, and institutions. The mercantile or the manufacturing and trading organization derives its principal receipts from cash sales and cash received from customers. Miscellaneous receipts are derived from a number of different sources, and may be said to consist principally of interest on bank balances, notes receivable and interest

thereon, interest on bonds and dividends on stocks. These items do not exhaust the list but serve rather as typical illustrations.

The cash sales may usually be verified. The entries in the general cash for cash sales may be supported usually in one of three ways. First, cash register slips or a daily record taken from the cash register; second, duplicate sales slips; third, a detailed memorandum book. The form of record in these different instances will differ. In the case of the cash register, all that will be obtainable will be the mechanical total for the day's receipts. This may be shown either by slips taken from the machine or the record which is kept in the daily cash book furnished by the cash register company. Duplicate sales slips will probably give all the details of the transaction, so that the auditor may go back as far as he likes on slips of that kind. It will usually be found that such slips have been totaled up for the day in some manner, either on the adding machine or perhaps on the comptometer and such slips will usually have been preserved, so as to show the details from which the daily totals were made up. It is not possible to check the items where totals are obtained through the use of the comptometer, because such machine does not list. The quickest way to prove such totals is to have the slips put through the comptometer a second time. It is not probable that the auditor would go into the details of the work to such extent. If the slips have been preserved and are presented without question, the presumption is that there has been no attempt at dishonesty. Mistakes may have been made but the probabilities are that they are slight ones and not worthy of discovery. It is not probable that the auditor would check up the total sales slips against the daily list even if the adding machine list were available. The particular point to be observed is that the slips are there if wanted.

If neither of the two foregoing records exist, it is likely that a memorandum book will have been kept. It may be just a blotter as in the grocery store in which a clerk writes down 3 lbs. of coffee at 30 cents under the name of Mrs. John Smith. On the other hand, not as much information as the foregoing may be found. It is possible that only the item of 90 cents will be entered into the memorandum book in the money column and the receipts for the day added up. In some manufacturing concerns where large quantities of supplies are sold, there are elaborate

systems of accounting for cash sales. Comparatively few, however, it is thought, make a record of the articles and quantities sold. Rather than not it is apt to be the case that the man in the stores department who has charge of the sales, jots down the amount he takes in, foots up the total at the end of the day, and at the end of the day or month turns over the receipts to the cashier, such record being the only one found.

Cash received from customers has in the past been a most unsatisfactory item to verify. The auditor has had to be content with checking the amounts against the customers' accounts with the hope that before the audit was completed, a statement would be sent to each customer with the balance, with a request for confirmation, and in that way a partial check of the amount of the receipt would be obtained. Unfortunately many customers are careless about returning statements, even when requested to do so, all of which interferes with the completeness of the proposed check. There has recently come into use in a somewhat sporadic way, a scheme which seems to be an excellent one, not only from the point of view of the merchant, but also that of the accountant or auditor who is called upon to verify receipts from customers. Within the past year a number of leading department stores in New York City have adopted the scheme. It consists in using a perforated invoice so that one part may be retained by the customer and the other returned with remittance. The invoice has been used in two ways. The first is the regulation invoice made out in every respect as formerly, with the perforation at the top where the body of the invoice begins. If the customer pays by check and no receipt other than that on the back of the check is desired, he tears the invoice apart at the point of perforation, returns the upper part showing his name, address and ledger folio, as well as the amount, and retains the lower part showing the items and total amount. When used in the other way, the invoice is of the same form and prepared in the same manner as before, except that the perforated portion is at the bottom and duplicates the information relative to name, address, folio and amount which appears at the top of the invoice. In this case, the perforated section is torn off and returned with the check, the invoice being retained by the customer. This scheme not only saves postal and clerical labor to the merchant because of the fact that he has no receipted

invoice to return, but it furnishes a satisfactory voucher, as it were, to the auditor in support of the receipts from customers. It is in fact a remittance slip. It comes in with the check. The check goes to the cashier to be entered in the cash book. The remittance slip goes to the bookkeeper who keeps the customers ledger. This procedure facilitates the work since it provides the bookkeeper with something to post from immediately; at the same time the cashier is making the entry if desired. The remittance ultimately goes back to the cashier to support the cash receipts. The use of this scheme by an increasing number of concerns would be a great boon to the accounting profession. If slips of this kind are not found and they probably will not be for some time, until the practice becomes more general, about the only thing to do in so far as the verification is concerned, is to check the cash received against the customers' accounts to see that when cash was debited the customers' accounts was credited. This, if followed up later by sending out a statement for confirmation, will be as good a confirmation as an auditor may hope for.

With regard to miscellaneous receipts, no fixed rule may be laid down. Good sources of verification will have to be searched out according to the items involved. A good source, for example, with regard to interest on bank balances, would be the usual monthly statements which some banks and trust companies send depositors. These statements show the amount of interest which has been credited to the depositor's account. There might be obtained of course a certificate or statement from the bank or trust company, showing how much had been credited during the entire year. This might, however, not be possible as such banks might take the position that having rendered a monthly statement, they were not called upon to go further. Some judgment must of course be displayed in determining how diligent an auditor should be in verifying items of this kind, since their size and importance may not justify the expense of any considerable time in order to verify them.

Interest on bonds is not so difficult to check. Knowing the par and the amount of the holding, and finding out the rate of interest paid and the dates on which it is payable, the amount of interest received or receivable should be determined without difficulty.

Dividends on stocks may be checked through newspaper records such as dividend notices, or reference may be had to the *Financial and Commercial Chronicle,* or *Moody's Manual.*

Institutions and associations usually derive their principal receipts from subscriptions, donations, dues, collection boxes, collectors, and in the case of hospitals, pay and dispensary patients. Miscellaneous receipts of such institutions take the form of legacies and bequests, interest on bonds, dividends on stocks and interest on bank balances.

Some subscribers promise to pay specific sums at regular intervals. It may be found that since these promises are usually made in advance, a list will be made up prior to the day that payment is due, or it may be found that the names of subscribers together with the amounts involved are placed on cards. When the payments come in there are four different ways in which the details may be recorded. First, the list with the name and amount to be received scratched off, indicating that it has been received; second, the amount of the payment either checked on the card if it has already been entered, or entered on the individual card either front or back, the card occasionally taking the form of a small ledger account where the subscriber will be charged with the amount subscribed in the formal way and credited with the money when it comes in; third, a stub for the receipt which has been sent out; fourth, a duplicate or carbon of the receipt. The last is the best form since a copy of something which has gone out to the individual is available.

There is a way of checking up the information found on the stubs or entered on the card or a list, namely, publishing a list of subscribers with the amounts subscribed. This is done by many institutions. Such practice seems to be desirable and perhaps should be suggested by the auditor if it is not the practice. A person subscribing to a given activity upon seeing a list of subscribers which has been published, immediately looks through the list to find his name and ascertain if his subscription has been reported in the right amount. There is no objection to making use of psychology or any other fair means of verifying things of this kind. Sending out such a list with the annual report has the effect of an automatic check on the subscriptions.

What has been said of subscriptions may be applied equally well to donations. Donations do not differ from subscriptions

except that they are usually smaller in amount and more or less infrequent in their receipt. Rarely will a list be found in this respect. They may, however, be accounted for through stubs or duplicates or carbons of receipts.

Receipts through collection boxes are most unsatisfactory to check. Without an elaborate organization and a somewhat elaborate mechanical provision, it is almost impossible for a society or institution to tell whether or not all collections are turned in. The auditor has very little opportunity of verifying these amounts. If the collection boxes are placed in stores or other public places and sealed they may be opened and the contents verified in the presence of some representative of the store, for example, who furnishes an independent certificate as to the amount.

There is absolutely no way, so far as the author has been able to discover, after having given what seems like an unwarranted amount of thought to the matter, whereby receipts taken up by collectors on the street and in other public places may be verified. The institution seems to be at the mercy of these collectors and must be satisfied with whatever is turned in.

In the case of hospitals where some patients pay board a receipt book with a stub or carbon copy of the receipt may be found. Such institutions, except in the cases of the largest ones, are not apt to be over-systematized and the auditor may consider himself fortunate if he finds the name of the patient with the amount paid and the date entered in the book. There is little check on dispensary patients since all patients do not pay. While the general impression is that dispensaries are free, it is probable that most of them exact a charge of those who are able to pay. Some dispensaries it should be said to their credit do keep records which can be checked. These records show the total number of patients treated in each clinic; the number of those who paid and the number who were treated free of charge. It is more than apt to be the case that no record, even such as that of a cash register, is kept. After all, as a practical matter, the amount involved is usually so small as not to warrant very much anxiety.

Legacies and bequests may be verified by correspondence which will be found in the files or can be produced. If the legacy or bequest is of sufficient size, a resolution extending the thanks of the institution will usually be found in the minutes of the governing board. These items, as a rule, are of sufficient

size and importance to warrant following each one up separately. Miscellaneous receipts in the case of institutions may also be checked in the same manner as that indicated for mercantile concerns.

The principle involved in the checking of receipts is to get some confirmation from the second party to the transaction. If such outside party can be gotten to verify the transaction it is a better check than the records of the organization undergoing audit. It need not be expected that verification will be gotten by word of mouth but rather through some communication or statement which has been reviewed by the second party.

No matter what the organization may be, receipts should be checked with the bank deposits to see that all receipts have been deposited and deposited promptly. The checking of receipts insures the deposit of all receipts shown but not necessarily the entry of all cash actually received. Such is the reason for going back to the second party to the transaction. The mere fact of the entry of the amount in the cash book being shown as having been deposited in the bank does not prove that all the money which a customer paid in has been entered in the books.

CHAPTER XII

Reconciling the Bank Account

At this point it is probable that the bank account or accounts should be reconciled. If all the checks are drawn on one bank and entered in numerical order, it may be possible to combine the reconciliation of the bank account and the vouching of the disbursements. Take, for example, a case where the checks are all on one bank and the cash book appears with regard to the credit side in accordance with the illustration below;

Date	Check No.	Payee	Net Cash	Discount	Accounts Payable	General Ledger

The returned checks, by which is meant checks which have been paid and returned by the bank, may be found arranged in two ways. The first is in the condition in which they were returned by the bank, namely, done up in packages and arranged in accordance with the order in which they were paid and listed by the bank. Otherwise, they will appear in numerical order as issued. Some little thought needs to be exercised before disturbing them if they are in the same order as that in which they were returned by the bank. Finding the checks in the original bundles, as they were returned by the bank, means probably that the bank account has not been reconciled for some time. Some banks use pass-books, while others have done away with the pass-books and use a monthly statement on which the paid checks as well as the deposits are listed. Having in mind that the account, or list, as the case may be, was not checked up at the time it was received, the lists as shown by the bank statement or the machine lists alone, if a pass-book is used, should be checked before the checks are put in numerical order. It is

important that the order of the checks be not disturbed until each statement has been proved; otherwise it may be exceedingly difficult to allocate the trouble in case a difference results in the attempted reconciliation. Taking the statement for the month of January, for instance, the returned vouchers should be checked against the entries on the statement or against the machine lists. The machine lists should be footed, since it is not safe always to accept machine footings. The machines are probably accurate ninety-nine times out of a hundred, but since there is a possibility of their becoming deranged and not giving correct results, it is always safer to foot machine lists. After having checked the machine footings to the statement, the items on the statement, both debit and credit, should be footed, the opening balance checked from a preceding statement and the closing balance proved. Continuing with the succeeding months in the same way, if all are found to be correct, the checks may be put in numerical order since breaking up the order in which they came from the bank is no longer a matter of importance. In putting the checks in order a memorandum should be taken of the missing numbers and reference should be had to the cancelled checks in order to ascertain if any of the missing numbers are represented by cancelled checks. In the case under illustration here no stub book is used, the cash book takes the place of the check book and the checks are arranged in numerical order and put up in pads. Where this situation does not exist, reference to the stub of the check book in the case of missing numbers will usually show whether the check has been cancelled or is in reality outstanding. Cancelled checks are, where good practice is in force, pasted to the stub, or preserved in numerical order.

In the case used for illustration it should be remembered that there is no check book. The auditor from the minutes or from some other source will have ascertained who is to sign and countersign checks. Remembering further that the process is a combined one, namely, reconciling the bank account and vouching the cash disbursements, the procedure will be as follows:

First: Compare the number of the check with the number in the cash book.

Second: Compare the payee on the check with the payee in the cash book.

Third: Compare the amount of the check with the amount entered in the cash book.

Fourth: See that the check is signed by the proper party or parties.

Fifth: Put a small double tick to the right of the amount in the net cash column.

There now arises a question as to whether or not the check should be turned over and the endorsements examined. The author is aware of the fact that certain authorities on the subject recommend turning over the check and examining the endorsement, also that certain teachers advocate the same thing. Personally, he is of the opinion that the auditor need not, except under certain circumstances concern himself with the endorsements if the check has passed through a bank, been paid, cancelled and returned. Several years ago while reconciling an account in the Market and Fulton National Bank, the following printed statement was noticed in the front of the pass-book—"The United States Courts in recent decisions have held that a depositor is bound personally or by his agent, and with due diligence to examine his pass-book or statement of account, and to report to the bank without unreasonable delay, any errors which may be discovered, and if he fails to do so and the bank is thereby misled to his prejudice, he cannot afterwards dispute the correctness of the items shown in the pass-book." The thing which stands out in the above quotation is the fact that the error must have been discovered within a reasonable time. Most banks nowadays, either in their pass-books or on their statements, notify depositors that if no errors are reported within ten days, the account will be considered correct. Ten days is probably the general rule. Ten days may probably be considered as a reasonable time within which the bank must be notified. The reason for this precaution on the part of the bank is probably not the fear that some clerical error will have been made in balancing the pass-book or preparing the statement, but that the money will have been paid to the wrong party. This, notwithstanding all the care which is taken in paying out money on checks. It is difficult for a stranger who presents a check at a bank to succeed in having it cashed. Paying-tellers invariably ask for identification and a stranger in a place like New York

City might have difficulty in getting anyone to identify him. Even where the identifying party is known to the bank teller, it is often necessary for such party to have an account with the bank. Sometimes such parties will be asked to place their endorsement on the check. It is well nigh impossible for a person to go into a bank where he is a stranger and get a blank check. Every safeguard is thrown around the cashing of checks, but with all, the banks seem to stand in constant fear of having been victims of a sharp trick or having paid the money to the wrong party.

Even if such were the case the auditor would have little chance of discovering it. He is not familiar with the signature, whereas, the paying-teller is either familiar with the signature or knows that the party to whom the money was paid was the party whose name appeared on the face of the check and that the endorsement on the check is the signature of that party. The paying-teller is in a position to take every precaution, but the auditor has no means whatever of discovering whether a signature is good or not. It may be seen that the name entered in the cash book is the same as that which appears on the face of the check. It may even be seen further, that the endorsement on the reverse side of the check shows the same name as that appearing on the face of the check, and still there is no proof that the person whose name appears on the face of the check received the money. Even going so far as to grant that the auditor might be familiar with signatures sufficiently to discover whether they were genuine or forged, there is not much chance that the discovery of the forged signature would be made within ten days after the rendering of the account by the bank. It is possible, of course, that some auditors might take up the vouching of the cash immediately upon beginning the audit, in which case a few checks would probably come within the ten days' limit.

If a check is drawn to cash it should be turned over and notice taken of who is purported, through the endorsement, to have received the money. Endorsements will not always be found as paying-tellers will occasionally, if they know the party, pay a check drawn to cash without requiring any endorsement. It would seem well if all paying-tellers would require endorsements even on checks drawn to the order of cash. The auditor

is put on special notice in examining checks drawn by executors or trustees, to ascertain through the scrutiny of the endorsements, who is supposed to have received the money on cash checks. This matter of examining endorsements on checks drawn to the order of cash is one distinct from the examination of the endorsements where a check is drawn to order of a specific party. The auditor should, it seems, exercise a trifle more care in the case of cash checks, altho he will frequently discover that such checks are entirely regular. A check may be drawn to cash and the check cashed by some employe who has charge of the payroll, so that while the practice is not a good one (the check being preferably drawn in favor of the party who gets the money), everything is in order so far as the use of the money is concerned.

A case has recently come to notice wherein the examination of endorsements would probably have led to the discovery of dishonesty on the part of an employe. A certain association, one of the purposes of which was to provide insurance, employed an adjuster to settle claims. The adjuster was provided with blank checks bearing the signature of the proper official and empowered to settle claims at such figures as he could arrange with the beneficiaries. He was in the habit of obtaining, wherever possible, the endorsement of the beneficiary on the check before making the settlement. He then agreed with the beneficiary as to the amount and settled the claim in cash. He subsequently filled in the check at any amount which he chose, being guided by what would be a reasonable amount to pay on each claim and deposited the checks in his personal bank account. Where he was unable to obtain the endorsement of the beneficiary on the check he forged the endorsement. It is said in this case that the auditor did not examine the endorsement, failed to discover the irregularity, and as the irregularity was discovered by representatives of the association soon after the audit was completed, the client refused to pay the auditor's fee.

There appear to be several sides to this case. The society was undoubtedly negligent in providing the adjuster with blank checks and in allowing him to fix the amount of the claim. These two functions should never be entrusted to one person, namely, fixing the amount of the claim and making the payment. In the second place, the bank seems to have been negligent in allowing so many checks of the association to pass through

the personal account of a representative such as this man was, without making inquiry as to the propriety of such transactions. Banks are on notice to inquire as to things of this kind, just as brokers are on notice to question checks of executors or administrators used by such persons in stock trading transactions of a personal nature. A certain firm of brokers was held on a deficiency judgment not many years ago for having accepted and credited to his individual account checks drawn by an executor to the brokers' order. In the case of the adjuster above mentioned, the auditor was undoubtedly negligent in that he is said to have been informed before beginning the work as to the status and authority of the adjuster. Here were special circumstances surrounding this case which should have put the auditor on notice. He presumably would not have discovered the forged signatures, since it is not probable that the adjuster personally forged all the endorsement, or if he did so, he would have seen to it that there was sufficient variation in the signatures not to attract attention. What the auditor would have discovered was that all these checks went through the personal account of the adjuster and this should have been cause for concern and special investigation.

Having finished the vouching the reconciliation may be made. For this purpose a sheet of journal paper will probably be found most convenient. It should be headed up as usual, with the name and address of the party whose accounts are being examined, and should show the name of the bank in which the account appears. Having received the certificate from the bank direct and not through the office of the client, the statement may be set up as follows:

The Warburton Desk Company — A. Read
Reconciliation of Bank Balance
at February 17, 1915

Balance (Feb 17, 1915) as per certificate attached		$ 4377.58
Less checks outstanding		
#1027	$ 32.50	
1143	void	
1454	27.38	
5	325.49	
6	75.16	
7	200. —	
8	17.15	677.68
Balance as per cash book folio 772:		
Footing debit	$ 48377.43	
" credit	44677.53	$ 3699.90

Bank Reconciliation

The above reconciliation is of course a simple one. There may be at times items of interest to be taken into consideration, or possibly deposits. The principle involved, however, is shown by the above illustration. There is no reason for beginning with the balance in the bank and working to the balance in the cash book, except that the figures which the accountant will use continually in his working papers will be those which represent the balance in the cash book. It is easier in looking over working papers and in checking up schedules supporting the working sheet, to have the figures which are desired appear at the bottom of the page and to stand out rather than to be obliged to hunt over the entire sheet for the figure which is wanted. The balance which the bank shows will almost invariably be different from the balance which the cash book shows. The auditor is verifying the figures of the client and not the figures of the bank.

If there are a number of banks instead of one as in the illustration shown, a number of different sheets may be used putting the reconciliation for each bank on a separate sheet and then preparing a recapitulation sheet which will go on the top in order to show the total for all banks. If the total for each bank is obtained, then the total of all banks added together should prove the cash, provided all cash has been deposited.

CHAPTER XIII

Vouching the Disbursements

The disbursements will, as a rule, be supported by checks. A check is the best kind of a receipt. In some instances, however, disbursements will be found which are supported, in addition to the checks, by receipts signed by the parties receiving the money. In some cases this will be a duplication of work so far as the bookkeeper is concerned, but there will be times when it will be found easier to vouch the disbursements from the signed receipts than from the checks. Here, the procedure with regard to the vouching will be the same as in the case of checks, namely, comparing the date of the receipt with the date shown in the cash book, the name signed on the receipt with that appearing in the cash book and the amount of the receipt with that in the cash book. Subsequent to these comparisons the receipts should either be ticked or stamped with a rubber stamp as below:

EXAMINED
NEW YORK UNIVERSITY
DIVISION OF APPLIED ACCOUNTING

The reason for putting this stamp or tick on the receipts is that receipts are not apt to be numbered, they are scattered about and available for anyone who desires to use them and there is a possibility, under such circumstances, of their being duplicated. Very often it will be found on examining the books that there will be regular payments which will be confusing. Some party will get $8.33 every month, or on the twentieth of every month, and it might be an easy matter to present to the auditor certain receipts of this kind to support disbursements during the month of January and after they had been used by him to take them away and return them later as vouchers for the month of November or December. This sort of irregularity is apt to exist in connection with padded payrolls. If such receipts are stamped or identified in some way there is not much likelihood of their being used as a voucher a second time. The situation with the

check is different. The checks are numbered and the checks presumably are controlled by a series of numbers. If #1253 has been used once as a voucher, there is not much chance of its going through a second time six months or more later. If an irregularity of this kind were attempted it would undoubtedly attract the attention of the auditor immediately. This would hold true even though the amount happened to be exactly the same the second time. Of course, if the auditor is not careful in his vouching to watch numbers and names as well as amounts, such a thing might happen. Vouching of this kind is a waste of time and unless the check is properly examined and a comparison made of all the points mentioned the vouching may just as well be omitted. Where receipts are in a regular book and numbered and controlled it is not so essential that they be stamped.

It is probable that a word should be said with regard to institutions which are run on a cash basis and which take no cognizance of expenses until they have been paid and make no provision for accruals. Such institutions, it will be seen, would have no purchase journal or voucher register and no way of getting the distribution, that is, the charges to the various accounts, except through the cash book. Such a cash book as is suggested is usually found to be a big cumbersome columnar affair. In connection with this cash book it is customary to find a formal cash voucher. It will usually be a printed blank form. The vouchers will be numbered in consecutive order with a place for the date, the name of the payee, the amount and the description of the purpose for which the disbursement is to be made and a place for some person or persons to approve the disbursement. These vouchers also show the distribution, that is, the accounts affected. A voucher for $1,000 may represent charges to five or six different accounts. If the classification of the accounts is very extensive, it will usually be found on the reverse side. Opposite each item in the classification will be shown the amount to be charged to each account. In such cases, it should be the auditor's task to run through these different accounts, occasionally checking the distribution on the voucher from supporting papers if there are any and proving the items against the total. With regard to the vouching the procedure will be the same as that previously indicated. Here, probably if the vouchers are numbered, it will not be necessary to put a

rubber stamp on them. On the other hand, it will be necessary or desirable at least, to check the distribution in the cash book, that is, to see in addition to checking the total amount of the disbursement, that the amounts entered in the respective columns of the cash book are the same as the amounts indicated on the voucher to be charged to the respective accounts.

The question is frequently asked, How often should distribution be checked; should every voucher be examined for distribution, or how many? There is only one satisfactory answer to the question, namely, "if you wish to be sure that the distribution is correct, check every voucher." This is as a rule out of the question and the auditor will undoubtedly have to be satisfied with testing. He will not generally be able to go further than the arithmetical accuracy. He will not be able to decide whether or not the sum was disbursed for the purpose stated in the voucher and which the distribution represents. Some officer or representative of the association will know, however, and such person should so certify on the voucher. The auditor is not required to go back of this certificate unless he has reason to be suspicious. His duty seems to end with a careful examination of the voucher to determine if it is in order and reasonable, has been properly approved, and is arithmetically correct. He is more concerned with the total than with the distribution and it will probably be sufficient if he tests the distribution on every fifth voucher. If twenty per cent of the work, in so far as the distribution is concerned, is examined and found correct, the presumption is that there are few mistakes. Further, if the work in the cash book is properly carried out by the auditor, a somewhat automatic check on the distribution is obtained, provided the entries have all been properly made. If the distribution is checked into the cash book and the totals of the distribution columns in the cash book are cross-footed at the end of the month into a total column, it would seem to be sufficient. It is possible that twenty per cent of the distribution on a voucher is not enough to check. Fifty or sixty per cent is advocated by some authorities, the claim being made that if fifty per cent is checked, one is sure that the person who did the work was correct at least half of the time.

The footing of the cash book is so closely related to the matters just discussed that it is undoubtedly appropriate to take

up the question of footing here. The auditor should foot the net cash and discount columns on both the debit and credit sides from the beginning of the period to the end of the period, unless all receipts have been deposited in the bank and all disbursements have been made by check. Then, provided the disbursements have been vouched and the bank account effectively reconciled, no footing need be done in the general cash book. In order that the reason for the above rule may be apparent, the following illustration is presented:

Receipts	Disbursements				
$	#	$			
25.	1	32.			
35.	2	26.			
75.	3	19.			
85.	4	12.	Bank balance		$ 183.
90.	5	5.			
	6	17.	Less outstanding:		
	7	13.	#6	$ 17.	
	8	6.	9	4.	21.
	9	4.			
	10	14.	Balance		$ 162.
		$ 148.			
	Bal.	162.			
$ 310		$ 310.			

In this illustration there are so few items that it can be seen at a glance that the balance as shown by the tabulation of receipts and disbursements does not agree with the balance as shown by the reconciliation. The error is seen immediately to be one in the cash book. There are five possible ways in which the error or errors might have occurred:

1. Some item in the receipts incorrectly entered.
2. A mistake in footing the receipts.
3. Some item in the disbursements incorrectly entered.
4. A mistake in footing the disbursements.
5. An error may have been made in subtracting the disbursements from the receipts at the end of some month when the cash book was balanced.

If all receipts were deposited and all deposits checked against the receipts, the first possibility will then be removed. This would show that all items on the receipt side had been correctly entered. There may have been a great many receipts. Each receipt may represent the account of a different customer. One thousand receipts may be represented by one deposit in the bank and it is an easy matter to list or foot up the receipts from the pass-book or from the statement which the bank renders. This may also be done on an adding machine and in such manner the footings may be proved. Thus the second possibility is removed. In checking the checks which have been through the bank and returned, against the disbursements, it will have been discovered whether or not an item has been incorrectly entered. In taking off the list of outstanding checks and deducting the totals of this list from the amount shown in the certificate, the correctness or incorrectness of the vouching of the disbursements will be established. By these two processes, possibilities number three and number four have been eliminated. The fifth is a simple matter since there are not likely to be more than twelve times in which the balance in the cash book has been struck during the year. Footings in a cash book are usually carried forward according to receipts and disbursements respectively until the end of the month is reached, when the balance is ascertained. Consequently the work of investigating the closing figures in the cash book at the end of the month is the work of only a few moments.

If the procedure as indicated by the rule has been carried out no footing need be done, provided the bank balance has been effectively reconciled. If the reconciliation has not been effected, comparison of receipts with deposits and disbursements with checks having been made, the receipt side of the cash book should be footed and a trial made of the twelve monthly balances. This will exhaust all the possibilities except the disbursements which it will then be necessary to foot. The task of footing disbursements may be turned over to the employe of the client who runs the cash book.

The auditor should discourage the practice of not depositing all receipts. Some concerns follow the scheme of putting money into a cash drawer while depositing all checks. Others draw round amounts for payrolls and throw any unused portion in the cash drawer. The practice of putting money into a cash drawer, to be paid out without going through the bank account, is, in the opinion of the author, wrong. From the point of view of the client it offers an opportunity to employes for irregularities. From the point of view of the auditor it is undesirable since it makes his task more difficult. Where this practice is followed it becomes essential that the cash book be footed. The footing should embrace both the debit and credit side and extend from the beginning of the period to the end of the period. At the end of each month's business, as shown in the cash book, the cross-footings should be proved.

The cash book footings at the end of each month should be checked with the general ledger. There are four ways in which these postings may be checked. One is to check from the cash book to the ledger; another is to check from the ledger to the cash book. Still another way is to abstract the postings from the cash book on a separate sheet and check them into the ledger. The fourth is to abstract the ledger and check to the cash book. This, of course, applies to the general monthly postings from the cash book and not the posting of details to the underlying ledgers.

A great deal of discussion is frequently indulged in as to whether the ledger should be checked from the book of original entry or vice versa. That is to say, should the auditor begin with the figure in the cash book and trace it to the ledger, or begin with the figure in the ledger and trace it to the cash book?

A hypothetical situation will perhaps clear up certain ideas which may exist on this point.

JANUARY, 1914 (Page) 32

Total	General Expense	Salaries	Office Expense
1,000.00	500.00	300.00	200.00
(27)	(74)	(76)	(78)

GENERAL EXPENSE (Page) 74

1914								
Jan.	31	C.C.	32	500.00				

In the above illustration the bookkeeper, or whoever did the posting, probably credited cash on page twenty-seven with $1,000, charged expense on page seventy-four with $500, salaries on page seventy-six with $300 and office expense on page seventy-six with $200 and went from the cash book to the ledger. If the auditor were to follow the same order, it is possible that he might, if the person who did the work originally made a mistake, check the mistake. There seems to be, on the other hand, a somewhat greater chance of his discovering the error, if in checking he follows the reverse order. The question does not seem to be an extremely important one, but if there is any choice it is probably to be given to that procedure which checks the postings in the reverse order.

A somewhat different and more convenient method of checking postings, is to tabulate or abstract the postings on analysis paper as they appear in the illustration below:

	Total	General Expenses	Salaries	Office Expenses
1914				
January	$1,000	$ 500	$300	$200
February	5,000	4,000	500	500

The information concerning the months following February will be put down as in the case of the months shown in the illustration. It is then an easy matter to turn, for example, to the general expense account in the general ledger and check the twelve items one after another. This would take much less time than turning to the general expense account on twelve different occasions and checking one item each time. This, it is thought, will bring out sharply the principle involved in the saving of time through the abstract of postings.

What is known as abstracting the ledger will also offer the same opportunity of facilitating the checking of postings. Abstracting the ledger as commonly referred to, means going through each account and setting out for instance, with regard to cash, the debits and credits which appear in the account. It will thus be seen that after all the accounts in the ledger have been gone through in this manner, there should be shown the total debits and credits of cash pertaining to the period, and the respective totals of each should agree with the debits and credits in the cash account in the general ledger and the cash book. Abstracting the ledger usually means following out the procedure just indicated with regard to all other books of original entry in addition to the cash book. The author once discovered a $10,000 shortage by analyzing or abstracting a ledger. The practice should, however, be followed with judgment as it consumes a great deal of time as a rule.

With regard to the checking of postings in simple cases, it may be said that they may be checked from the cash book to the ledger, if desired. Where the transactions are numerous, the volume of business and the number of postings large, they should be checked from the ledger to the book of original entry. In either case the use of the abstract of footings will be entirely satisfactory because of the fact that in so doing an independent

posting medium will have been raised and an independent check obtained which is likely to guard against passing over errors.

Detail postings where they affect underlying ledgers such as creditors and customers, should be checked to the extent probably of fifty or sixty per cent. This may seem rather high and will perhaps be in some instances. The circumstances in each case should dictate. The checking should also be spread about. It is not desirable to take the first month or the last month, but rather a month here and a month there, or perhaps every other item, so as to cover in the checking as wide a field as possible.

Another point which should be mentioned before leaving the subject of general cash, concerns the practice of holding the cash book open at the end of the period in order to get in as many receipts as possible. In a case which recently came to notice, the fiscal year closed on September 30. The cash book was held open and there were taken into the accounts for the fiscal year ending September 30, actual cash receipts up to and including October 23. It is important that the auditor should watch matters of this kind and throw out both at the beginning and the end of the period receipts or disbursements which do not strictly apply thereto.

CHAPTER XIV

The Petty Cash

The auditing procedure in connection with the petty cash may perhaps best be brought out if discussion is first had of the two ways in which petty cash accounts may be handled.

Let the illustration below represent a petty cash account in the general ledger:

Petty Cash

$50.00	$42.82
40.00	37.50
75.00	32.43
30.00	76.82

One way of handling petty cash consists in transferring an amount from the general cash to the petty cash and charging it up to the petty cash account in the general ledger. The total amount of the disbursements for the month, for example, $42.82, becomes in effect the subject of an original entry through which certain expense accounts are debited and petty cash is credited. A further amount is then transferred to the petty cash and debited to the account. This time it may be $40 and further amounts in subsequent months may be $75 or $30, or any amount which it is estimated will be needed. Each month in turn the disbursements will be put through on the credit side.

The other way of handling petty cash is to have $50, for example, transferred to the petty cash fund and charged up to the petty cash account in the general ledger. This would appear as below:

Petty Cash

$50.00	

At the end of the month or at any other time convenient, the disbursements are totaled up. A voucher is then made and a re-imbursement check to the order of petty cash drawn. The manner of handling the voucher will depend on the system in use. In some cases where distribution is obtained through the cash book, the voucher is treated like any other disbursement and put through the cash book debiting the appropriate expense accounts through the distribution columns of the cash book. In other instances, where a voucher register is operated, the regulation voucher is made up, the expense accounts debited through the distribution and accounts payable credited. The cash book entry then debits accounts payable when credit is taken for the disbursement.

There are two ways of operating the general ledger account even when the amount of the petty cash is fixed. In the first way the account is credited with $42.82 when the voucher is put through and charged with $42.82 when the re-imbursement check is drawn. This idea is carried out from month to month. The second of the two ways shows an account for the petty cash fund in the general ledger which has been charged with $50. No other entry is ever made in the account unless the fund has increased or decreased.

Bookkeepers very often inquire whether the fixed or the fluctuating fund is the better. Also in the case of fixed funds whether the account should show just one debit and nothing else, or whether subsequent debits and credits should be shown? It is probable that the fluctuating fund is less desirable, not only from the point of view of the auditor but from that of anyone else who has to supervise the petty cash. This is because it is necessary to ascertain before a balance may be checked how much has been received by the person handling the fund. The advantage of the fixed fund is the fact that one is able to tell by looking at the ledger or the trial balance, that the person in charge of the fund should have a certain amount, say $50 in cash or paid vouchers. Most auditors should, it seems, prefer the latter method over the first since it facilitates their work; also the scheme of showing the subsequent debit and credit items even though they represent only disbursements and re-imbursements. If the debit and credit items are shown, one may see at a glance the relation of the fund to the disbursements, which in substance

means determining whether or not the fund is adequate. Further than this, it enables one to compare the amount of the disbursements month by month. If they run at about the same amount each month and then suddenly rise, the fact is brought to the attention immediately by looking at the account. Where there is a summary and the operation of the petty cash account can be seen, a historical record of the transactions is afforded. This record is sometimes convenient since it shows how much time usually elapses between the preparation of the voucher and the re-imbursement for same. This is specially true in the case of branch offices where the petty cashier is at some distance from the general office. The record shows that the voucher was received on a certain date and that the re-imbursement check was issued on a certain subsequent date.

The auditor who is having his experience of counting petty cash for the first time will undoubtedly appreciate the advantages of the fixed petty cash fund. Where the other method is in use he will be obliged to get a transcript of all the petty cash checks which have been issued to the person in charge of the petty cash since the last accounting in order to know the total amount with which to charge him. As a practical matter it is very embarrassing to skip an item and perhaps accuse a cashier of being out of balance. With the second method, where the fund is fixed, the chances are that a mistake of this kind will never be made. The amount which should be found is ascertained from the posting of the original entry in the general ledger account and the auditor may expect to find cash or vouchers in that amount. If the amount of the original fund has been increased or decreased the ledger account will show same.

So far as the auditing of the petty cash is concerned, both these methods must be taken into consideration because of the fact that they are both in general use. With the first it is necessary to get a transcript from the general ledger which will perhaps be supplemented by information from the general cash book. It would not be sufficient to take a transcript from the general ledger, if, for example, the auditor were counting the cash in the middle of December. In order to assure himself that nothing had been overlooked it would be necessary for him to run through the pages of the general cash book in order to discover if there were any items which had not been posted. In

the majority of cases probably postings to the general ledger accounts are not made oftener than once a month, consequently care must be exercised in cases of this kind with regard to the possible transactions between the close of the previous month and the date on which the verification is being made. In the second case, reference must first be had to the general ledger in order to determine the amount of the fund. It is also well to ask someone in authority if the fund has been either increased or decreased since the close of the last month.

So far as the procedure on the credit side of the account is concerned, it will be the same in either case. The auditing of disbursements is not affected by the system. The disbursements should be vouched, giving particular attention to the large items and using judgment as to how much vouching it is necessary to do. If the petty cash disbursements are found to be made up of a great many small items and the total amount involved is in itself small, a great deal of time would be necessary in order to vouch all the items and perhaps the expense incurred greater than the amount of the petty cash disbursements involved. It would not be good judgment under such circumstances to check out all the items. On the other hand, if the disbursements run into large amounts, it may be thought necessary to vouch every item and it may be worth while to do so. At any rate, entries for large amounts should be scrutinized and vouchers for same examined. It is difficult to lay down any hard and fast rule as to the amount of vouching to be done. The auditor must in this particular be guided by what is necessary to satisfy himself in each particular audit.

Items will sometimes be found for which no receipts or vouchers can be produced. It is not probable that where postage stamps are purchased in small amounts, a receipt could be obtained from the post office department. There are other cases where it will not be possible to get a receipt. Street car fare and railroad fare and similar items are as a rule not supported by vouchers. Very often it is necessary for the petty cashier to take a receipt from some person such as an office boy or messenger boy who pays out the money. Not infrequently entries have to be accepted for which there are no vouchers.

The distribution of any large items should be checked, the total columns footed, cross-footings proved, the posting of totals

checked, the balance in the petty cash account agreed with the count of the cash. The balance should be worked back to the date at the end of the period covered by the audit. The latter will not be necessary if there is a fund in a fixed amount, since such fund is presumed to have existed at all times in the amount shown by the ledger.

It is rather difficult to formulate rules with regard to petty cash books because of the fact that they take so many different forms. Sometimes there will be simply a memorandum book without any ruling at all. It is not unusual to find a stenographer's note book being used for this purpose. At other times it will be a big formal columnar ruled book similar in appearance to the general cash book. There seems no reason why it should not be ruled and ruled in columns so that the distribution may be made at the same time as the other entries. The author once ran across a man keeping a petty cash account who was a porter and general utility man. What he did was to jot down in a note book the amounts disbursed, showing what they were disbursed for and continuing this procedure for a year. At the end of the year the bookkeeper took this book and on a big sheet of paper (not even analysis paper) headed up with the various accounts, put down the amounts under their respective heads until all the disbursements for the year had been entered. Such procedure seems to be rank waste of time. It is just as easy if distribution is to be made, to distribute immediately after the entry has been made in the total column, so that when the end of the month or the end of the year arrives, the work is completed. In one case it is ready when it is needed. In the other case, the work is postponed and piled up and when the information is required it is not immediately available. It is not improbable that the auditor may do considerable missionary work in respect to small matters of this kind by criticizing in a tactful way where work is being improperly done and offering suggestions for improvement in method or system. The opinion is ventured that the influence of auditors as well as graduate students of the subject of business and accountancy has been greatly felt in the business world in the past decade. Untold opportunities, however, in this respect still exist.

One other thought in connection with the subject of petty cash suggests itself. This concerns petty cash funds at branch

offices. In such cases it is customary to find monthly statements or reports sent in to the head office. Just like petty cash books, these reports vary greatly in form. They depend, of course, upon the system in operation. In substance they are all the same. The information which they show is usually presented as an account. The amounts received by the branch office appear on one side of the account; the disbursements on the other side. The disbursements are usually accompanied by vouchers. These monthly statements or reports should be audited just as a person would audit the petty cash book. This would involve checking first the balance brought forward, verifying the receipts from the home office records, the disbursements from the vouchers, footing both the debits and credits and proving the balance.

CHAPTER XV

Vouching the Purchase Journal or Voucher Register

The title of this chapter may raise a question in some minds as to what difference there is between the two books. This perhaps is a matter which belongs to accounting rather than to auditing and may not be entirely in place here. It is not the intention of the author to deal with the theory of accounting nor with system work. Matters such as pointing out the distinction between these two books seem, however, to warrant consideration if the proper foundation is to be laid and the auditing discussion made entirely clear. The rulings for the respective books appear below:

PURCHASE JOURNAL

	Total	DISTRIBUTION		
		Heat	Office Expense	General Expense
Billings and Bakner..........	$15.00	......	$15.00	......

VOUCHER RECORD

	Total	DISTRIBUTION		
		Heat	Office Expense	General Expense
Billings and Bakner..........	$15.00	......	$15.00	......

In connection with the purchase journal there will be ledger accounts such as the one appearing below:

Billings and Bakner

$15.00	$15.00

If a single invoice from Billings and Bakner in the amount of $15.00 might be taken as an illustration, the procedure would, in the operation of the purchase journal, be as follows: Invoice received, goods checked with invoice, price verified, extensions

and footings checked, invoice entered in purchase journal, showing the name of the creditor, the total amount and the distribution. At the end of the month the purchase journal should be footed, the amount in the total column credited to accounts payable controlling account, the amounts in the respective distribution columns posted to the appropriate accounts in the general ledger. The details affecting creditors would be posted from the purchase journal to the individual creditors' accounts in the creditors' ledger. The account used for illustration would show a credit of $15.00 when this posting was made and a debit of $15.00 when the account was settled through the payment of cash.

Where a concern has sufficient cash to pay all accounts promptly and where the total of invoices will be paid at one time instead of paying something on account, the bookkeeping work may be greatly reduced by eliminating the ledger for such individual creditors' accounts and combining the ledger and journal function in one book called the voucher record. This book is very often known by other names, such as the voucher register, audited vouchers, audited voucher record, etc. If the journal function is not altered, the entries are made precisely as in the case of the purchase journal both with regard to total and distribution. Instead, however, of opening a ledger account with each individual or creditor concern, a single line in the voucher record is used, namely, the line opposite the creditor's name in the paid column, the same thing is here accomplished as if the formal ledger account were opened. The entry in the total column shows the credit. The date of payment in the paid column serves as the debit and wipes out the account. This scheme is only workable where the payment is in the same amount as the credit. Some variations of this voucher record have been seen where it was the practice to make payments on account but such schemes are not usually satisfactory.

With the ordinary use of the voucher register the invoices are handled in about the same way as in the case of the purchase journal and the bookkeeping procedure is also similar. Invoices instead of being entered individually as in the case of the purchase journal are held in a file, being sorted according to creditors until a sufficient number have accumulated, when they are entered on the voucher form, totaled up and distributed. The name of

the creditor, total amount and distribution are then entered in the voucher register. In this way only one entry is made in the book, whereas fifty entries might have been necessary in the purchase journal. There is no time saved since the same entries have to be made under either system but where the voucher register is used they are made on inexpensive voucher forms instead of filling up pages of expensive paper in the books, which pages have to be footed and carried forward. There may be of course a slight saving in this latter respect. Having entered the vouchers in the record, the footings and postings are made in the same way as in the purchase journal.

If the above discussion has succeeded in establishing the difference between the purchase journal and the voucher record, attention may now be given to the matter of auditing in its relation to these records. It may be remembered that in discussing the mechanical work, attention was called to the fact that it might be divided into three parts, namely, vouching, footing and checking postings. The footing and checking of postings will be precisely the same whether a purchase journal or voucher record prevails. The vouching is essentially the same in both instances. The method of checking, however, differs slightly in one respect. In checking a purchase journal there will be a separate invoice for each entry in the purchase journal. In the voucher record the auditor will perhaps, in most instances, see at first glance only the voucher. He must bear in mind that these vouchers are supported by invoices, and must spend a certain amount of time in ascertaining whether or not the invoices agree in the aggregate with the voucher and properly support it, and further, whether or not the invoices themselves are in proper shape. Having tested occasionally, perhaps every fifth voucher, the make-up of same, that is, having examined the invoices and checked them with the voucher and proved the footing on the voucher, the following rules may be laid down:

1. Compare the number of the invoice or voucher with the number in the book.
2. Compare the name of the creditor on the invoice or voucher with that in the book.
3. Compare the amount on the invoice or voucher with that in the book.

4. Tick the entry in the book at the right of the figures in the total column.
5. Stamp the invoice or voucher "examined."
6. In the case of every fifth voucher compare the distribution on the voucher with the distribution in the book.

In connection with this work practical difficulty will sometimes be encountered. As the vouchers are made out and entered in the voucher record they appear in numerical order. Once they have been entered they are filed away as a rule in alphabetical order because of the fact that if occasion arises for referring to a voucher, it is something that arises out of relations with the creditor and is apt to be wanted in connection with the account of same. As a rule no one except the auditor requires information concerning a voucher other than that which arises out of relations with creditors. If information were wanted with regard to Billings and Bakner, it would be most logical to look for the voucher in an alphabetical file. When the auditor comes to check the voucher record he finds that vouchers are scattered all through the files, some under A, some under B, some under C and not at all in the order in which he wishes to use them. Then arises the question of what shall be done. The thing to be done is to go to the client or his representative who is in authority and state the situation. It will take a great deal longer if the auditor is obliged to get out these vouchers and arrange them himself or check them as they exist than if someone else puts them in order for him. It will probably cost five times as much, so far as the auditor's services are concerned, to check the book one way as the other. On this account the question should, as a practical matter, be submitted to someone in authority. It will usually be found that the task of putting them in order will be given to some employe of the client whose time is not as valuable as that of the auditor. If the engagement has been taken on the contract basis, in which case the person making the estimate should have taken such things into consideration, the auditor will have to use his own judgment about asking for an increase in the fee unless he is able, through tact, to succeed in having some of the clerks do the work for him.

The total, and discount columns (trade discount), in case the latter appears, should be footed and the cross-footings at the

end of each month proved. Postings of totals should be checked to the general ledger. For this purpose an abstract of the postings will be found very convenient. This way will be found especially advantageous in the case of a voucher record where the distribution is extensive, using sheets of analysis paper for the purpose and if necessary pasting them together. These sheets should be headed up as usual and the totals abstracted by months. If this is done, one may turn to any given ledger account and the entire twelve items or amounts checked at one time. In the case of the purchase journal the individual items must be checked to the creditors' ledger. In the case of the voucher record, if such work has not already been done, the cash payments in the paid column should be checked. In connection with this latter point, while perhaps this matter does not come under the head of mechanical work, a list of the outstanding or unpaid items, sometimes called the open items, in the voucher record, should be made and the total compared with the credit balance in the voucher record account in the general ledger. This is the same thing as taking a trial balance of the creditors' ledger. If there were a ledger account for each creditor and the credit balance in each account were to be taken off and these balances added together, the total should equal the amount in the controlling account if the work has been correctly done. Here the open items take the place of the creditors' accounts and should prove up with the control in the same way.

It is not thought to be necessary to repeat the remarks concerning the procedure, as applied above to the purchase journal and voucher record, in the case of the purchase returns and allowances. The voucher in the latter case will be a credit memorandum received from purchase creditors.

While discussing the vouching of the purchase journal it may be desirable to include in the discussion, the other books which require treatment similar to the purchase journal. The sales book, for example, should be vouched from sales invoices. The number, name, and amount on the invoice should be compared with corresponding entries in the book. The entry should be ticked and the invoice marked "examined." Distribution should be occasionally checked. The total and discount columns, if there are any of the latter, should be footed. The discount columns referred to are those for trade discount which are found

in some cases. Cross-footings if they exist should be proved. Postings of totals should be checked to the general ledger, and the details to the customers' ledger.

Sales returns and allowances may usually be checked from a carbon copy of the credit memorandum. The procedure is the same as in the case of the sales book.

The payroll book should be vouched from receipts if there are any. The total column should be footed and the total footings checked to the general ledger. The distribution should be checked.

With regard to the general journal, both columns should be footed. The postings should be checked and any complicated entries should not only be scrutinized but studied carefully. It will be surprising at times to find how much light will be thrown on the situation if time is taken to study and understand what appears at first glance to be a complicated entry. The author has always contended that a prospective accountant who can take a series of transactions or statement of facts and put them into the form of a journal entry, has solved about half of his problem. A better test of a man's ability probably does not exist. If one cannot state things in terms of journal entry there is not much use in trying to go ahead since trouble will be sure to result. Consequently it seems that if an entry is found in the journal that is not at first understood, it merits attention and the auditor should not drop it until he is sure that he understands it. There is, of course, time wasted occasionally through stubbornness on the part of the auditor in seeking to understand complicated journal entries when he is too proud to ask someone to explain them. Care should of course be exercised in this respect.

Included with the above discussion might perhaps be the mechanical work in connection with the general ledger. Such work consists in checking the balance brought forward from old ledgers in case new ledgers have been opened; footing the ledger accounts and proving the balances if they have not already been proved in taking off the trial balance.

CHAPTER XVI

Inventories

Inventories may include materials and supplies, goods in process, finished goods, packing material, stock in trade, goods in transit, goods out on memorandum, goods out on consignment, coal, oil, waste, postage, stationery and printing, and scrap.

Inventories are of two kinds, book and physical. A book inventory is practically a trial balance of a materials and supplies ledger, or of ledger stock cards which are frequently used in connection with materials and supplies. There is no reason, of course, why the term may not be applied to any kind of stock, for example, goods in process, or finished goods, altho it is most frequently used in connection with materials and supplies. A book inventory of goods in process, etc., appears where there is a cost system.

A physical inventory differs from a book inventory in that it represents actual inspection and count of the stock at a given time. The time is usually the end of the fiscal year period, altho the count of certain articles may be made at the time during the year when the stock of such articles is at its lowest point in order to compare the count with the book inventory. Like the book inventory the physical inventory shows units, prices, amounts and total. In the one case the number of units has been obtained by actual count, whereas in the other the figure represents the balance which has been obtained by keeping track of the receipts and issues.

It may be said that there are five things concerning which the auditor will wish to satisfy himself with regard to the inventories. Assuming that the auditor has gone into the office of the client and has had presented to him a number of sheets purporting to contain the inventories. The sheets will contain a list of articles showing in each case, the number of units, the name of the material, the price at which the material is carried, the extension and the footings. In taking up the work the auditor will endeavor to satisfy himself as follows:

First: That the units of stock represented by the inventory were on hand at the date thereof.

Second: That the inventory contained no material which was obsolete or unserviceable.

Third: That the figures used in pricing the inventory were first correct and second, cost or lower.

Fourth: That the extensions are correct.

Fifth: That the footings are correct.

Taking these matters up in turn, it appears first that the inventory contains a statement to the effect that there are certain units of stock. These units were supposed to have been in the possession of, or owned by, the company at the date of the inventory. They were supposed to have been actually inspected and counted on that date. In perhaps nine cases out of ten the auditor was not there in person to inspect the articles and see them counted. He may, of course, take for granted that the inventory in this respect is correct. He should not, however, be satisfied with the fact that these articles have been put on the list. He should satisfy and protect himself by requiring a certificate from the person who counted and recorded the inventory, or better, some officer or reliable representative under whose direction the inventory was taken, certifying to the fact that all articles included in the inventory were on hand on the date in question.

The auditor should also ascertain whether or not the inventory contains any old stock; stock for which there is no longer any call; stock which cannot be sold, or at least not sold except as scrap. It very often happens that there will be around a plant, old material, partially completed goods, and sometimes finished product, which has little or no value; certainly not a value equal to the cost. Such old material is often carried year after year at cost. Concerning this matter, the auditor may satisfy himself by obtaining a certificate to the effect that the inventory contains no such material, and further, by making a casual trip about the plant and through the stock rooms, if practicable, and inquire particularly about any unserviceable material which he may observe, as to whether or not it has been included in the inventory. This point may raise a discussion at times and perhaps cause some objection on the part of the client, if the auditor is insistent on eliminating material which seems to be unserviceable.

Not long ago a case arose in which an inventory contained

certain articles which had been carried in stock for almost ten years. It was a business in which styles played an important part and the articles in question had become practically obsolete because of a change in the styles. While having had little value for practically ten years the demand for goods in which they played an important part having suddenly sprung up on account of a new style, these goods had an inventory value on December 31, 1914, of about thirty-five hundred dollars, whereas, a year previous they had scarcely been worth, figuratively speaking, thirty-five cents. Through a change in style, these articles which were as good as new, not only had an inventory value, but they had actually cost about fifty per cent less than present market prices when they were purchased. Similar cases are related where goods have been carried in stock for a long time at little or no value and have suddenly through the European war become much in demand and consequently now have an inventory value. Judgment must, of course, be exercised about things of this kind.

The auditor should assure himself that the prices are correct. He should see to it especially that there has been no mistake in setting down the prices to be used. Articles which should have been priced at one dollar and fifty-four cents may have been priced at twenty-seven cents. Or just the reverse may have happened. Occasionally prices become mixed. A concern may have some materials which are used in small quantities but are very valuable, whereas, other materials which are used in large quantities may be worth almost nothing. It is rather important to make sure that in setting down such articles high prices have not been inadvertently set down against large quantities, and low prices against small quantities. This may occur without any intention at all on the part of the client or his employes to over-value the inventory. It is merely a clerical error which is quite apt to be made.

It is probably the consensus of opinion that the inventory should be priced at cost unless the market is lower than cost, in which case, it should be priced at the market. This may perhaps seem inconsistent, since it is a difficult thing to get people who believe in cutting down the price if the market is lower than cost to increase the price if the market is higher than cost. This matter seems to have two different aspects. One is the effect on

subsequent costs. The other is the effect on the financial condition of the organization as represented by the balance sheet and taken in connection with the replacement of the items. If, for example, a certain article is purchased at eighteen cents a pound and the market price goes down to twelve cents, a manufacturer is not going to fool himself in the next period, having eighteen cent material on hand, by charging the material into his product at twelve cents. If he has bought it at eighteen cents that is what the material cost and that is the price at which the material is going to be charged into the product and the price at which it will effect the cost. Nothing would be gained by withholding that material and buying other material at twelve cents so that the latter might be temporarily put into the product in order to reduce the cost. Sooner or later the eighteen cent material will be reached and will have to be charged into the product. Whether it goes into the product at eighteen cents or whether it goes in at twelve cents while the difference of six cents is charged against profit and loss makes little difference in the effect upon the profits. It seems, however, that so far as charging the material into the product is concerned, it should go in at material cost regardless of fluctuation in the market.

There is, however, another point of view when the material is looked upon as an asset. A manufacturer who paid eighteen cents for certain material and may now replace it at twelve cents may, if he desires to be conservative, carry it as an asset in the balance sheet at twelve cents. Such course is conservative and no one may reasonably object to that position being taken. On the other hand, a person who accepts that theory will object to the product being marked up if the market has gone up. Whether the market goes up or down need not, it seems, concern one. What is on hand was bought in a certain market and at a certain price. The rise and fall in the market does not cause a manufacturer to rush in and buy or sell for the purpose of regulating his inventory. He may do so for financial reasons, which is a different matter. Notwithstanding all these discussions, as has been said, it is probably the consensus of opinion that conservative practice dictates the valuation of the inventory at cost or less if the market is lower than cost.

Where the market is lower than cost and it seems desirable to adjust the inventory figures for balance sheet purposes, such

adjustment may be accomplished through the operation of a reserve. This is preferable to actually adjusting the accounts for materials and supplies, since any adjustment of the total figure means an adjustment of the total figures from which the total is made up and which may entail an endless amount of work. If the market is lower on some of the items represented in the controlling account the amount of the inventory may be allowed to stand in the balance sheet as it was taken and the extent to which the market is under the cost in the respective items may be represented by an estimated amount which may be charged against profit and loss and credited to a reserve. This has the effect in the balance sheet of reducing the value of the inventory without changing the actual figures in the controlling account and consequently not requiring any changes in the figures appearing on the subsidiary stock or cost records. If, on the other hand, it ever becomes desirable to take cognizance of the rise in the market, the book figures need not be changed. Again, an entry may be made which will increase the balance sheet figure representing the materials and supplies and credit a reserve for the excess of market over cost. It is possible that some may object to this being done with respect to the balance sheet and not being done on the books. In such case an entry might be made in the books for closing purposes and reversed after closing.

It sometimes becomes a part of the auditor's work to be present at the time stock is taken, and at other times to suggest plans for the taking of the inventory. It is always much more satisfactory to him when he is present at the time the stock is taken, especially if he is called upon to give a certificate in connection with his audit. He may, however, be obliged to do the work at a time which is not as convenient personally as he would like to have it. Active retail stores and hotels, for example, are frequently obliged to take an inventory of stock, or in the latter case, of equipment as well as stock, at night. The author recalls instances where he was obliged to spend the entire night in observations of this kind. Mention is made of these matters in order to bring to the attention of a young man who aspires to enter the accounting profession the fact that the work is not by any means a sinecure and that he must be prepared to perform any kind of service required of him no matter how disagreeable or inconvenient it may be.

If the auditor is not requested to be present at the taking of the inventory, he may be asked to submit a plan for doing so. One engagement which comes within the range of the author's experience may be used to illustrate this point. A large concern manufacturing electric supplies requested a plan or scheme for taking the inventory. The plan suggested contemplated the use of slips made in two parts and perforated. One part was gummed and the force which took the inventory went through the stock systematically making the count and after noting the count on the two parts of the slips, pasting the slips on the boxes containing the supplies. A second squad followed, verified the count, tore off the perforated sections and initialed them. The slips were subsequently priced out, the extensions made and the record of the inventory completed. Where the prices were the same, slips were consolidated as far as possible and then priced out and extended as already mentioned. The slips served as vouchers, as it were, to support the entries. In this case the auditor had a first-hand voucher for the count from someone who had counted the materials and supplies. This, while perhaps not as satisfactory as seeing the material counted, was probably the next best thing. The first count was verified by a second squad and too many men were involved to make collusion possible.

In taking inventories it is quite important that boxes and cases be opened and their contents inspected. If the auditor is present at the taking of the inventory he is entitled to have all boxes and cases open, and should satisfy himself that he is not checking off empty containers as full boxes. While the auditor has certain rights in this respect, he must exercise some judgment and not make unnecessary work. If it so happens, as it will in the majority of cases, that the auditor has neither formulated a plan for taking the inventory nor been present at the time it was taken, he may accept a certificate concerning it. It is usually customary where certificates of this character are accepted, to go into the matter with the person who is responsible for or who had charge of the taking of the inventory, and ascertain just how the stock was taken, how it was priced out, the basis used for pricing and as much information concerning it as possible.

Another way in which the auditor may satisfy himself, partially at least, is through an approximation or test more than anything else which consists in working out the inventory from

the cost of goods sold, which cost has been obtained by using the net sales and gross profits on sales. As an illustration of this, supposing the inventory at the beginning of the period was $10,000 and the purchases during the period were $25,000, the total amount to be accounted for would then be $35,000. Assuming that the sales during the period were $25,000 and that there has been ascertained from the book in the preceding period, or from the statement of income and profit and loss of the preceding period, that the gross profit and loss was 25%, meaning 25% of cost. The sales of $25,000 would then represent 125% and the cost of the goods sold would be found by dividing $25,000 by 125%, or $20,000. By subtracting the cost of the goods sold $20,000, from the previous figure of $35,000 (the total to be accounted for), the inventory on hand at the end of the period should have been $15,000. This would, of course, be an approximation and would vary in accordance with the fluctuation in the different priced goods. If in this period under review there had been a large volume of sales of high priced goods the calculations would be affected. They would be affected in the same way if there had been a large volume of sales of low priced goods, because under such circumstances as well as those preceding the profit would have been more than or less than 25%. Since the 25% is an average on everything, the result of $15,000 might be slightly inaccurate. It would, however, it seems, be sufficiently accurate to serve a useful purpose since any marked variation such as a result of $6,000 on the inventory sheets or $27,000, for example, would be too far off to be allowed to pass without attention having been directed to the discrepancy. The figures used in this illustration may have been slightly overdrawn, but the purpose was to show how the result of $15,000 would serve as a basis for comparison, offer an opportunity to investigate more thoroughly and probably discover the real trouble.

Inventories, when considered with regard to prices, practically divide into three groups. In the first group may be considered everything except goods in process, finished goods and scrap. The second group may be said to be represented by goods in process and finished goods, the third group by scrap.

With regard to group one, the auditor should go into the question of prices through reference to the invoices. It will be out of the question to verify every item on the inventory so far

as prices are concerned. What should be done is to pick out the most important and higher priced articles and verify the prices from recent invoices. The prices used will, as a rule, be found to be those on the invoices representing the last purchase of goods. Sometimes an average price will be used and sometimes the price will include the allowance for inward freight and cartage. These purchase prices will sometimes be somewhat arbitrary and at other times the prices used will be somewhat arbitrarily fixed by a person whose judgment concerning prices is satisfactory. In a case of this kind it is desirable that such person be asked to explain why the price used was selected and why he thinks it is a proper price to be used. It is very largely a matter, so far as the auditor is concerned, in a case of this kind, in deciding whether or not he wishes to accept the judgment of the man who put the price on. If, after talking the matter over with him, it is thought that he is consistent, conservative and careful in fixing the price, the auditor may feel satisfied in passing it.

What needs to be said concerning goods in process applies in a large part to finished goods as well. The problem is much simplified if there is a cost system. Reference to the manufacturing or cost ledger will show the cost of the goods in process. If there is no cost system an estimate will have to be accepted and the goods will have to be segregated according to departments or according to the various stages of completion in which they were found at the time the inventory was taken. The estimate should include material used in the process of manufacture up to the point where the inventory was taken; the same with regard to labor and a percentage added for manufacturing overhead.

It would perhaps be somewhat inconsistent to proceed with an explanation of how to verify the inventory of goods in process without having described the manner of taking and pricing such an inventory. There may be used as an illustration of such point, a plant in which there are eight departments. Assuming, for example, that on December 31, the plant closed down and that the force assigned to the taking of the inventory went through the various departments counting such goods as were actually found. From the tabulation which appears below it will be seen that altogether there were two hundred units in various stages of completion. The material unit cost is shown with

regard to each department; also the cumulative material unit cost; the departmental cost of the goods in the various stages of completion, as well as the total material cost of $1,010.56. With regard to labor there is shown the departmental unit costs, the cumulative unit labor costs as well as the cumulative department costs and the total labor cost of $146.56. The way in which the overhead has been calculated will be described later.

In order to understand the situation better, it may be advisable to take up one or two items as shown in the tabulation. Suppose, for example, that the clerks working on the inventory, upon arriving at department number one, which represents the first operation in the process, find twenty-four units of goods partially finished so far as that department is concerned. If sharp lines of demarcation are drawn between departments or operations, it should be an easy matter to determine the extent to which material has entered into the product. The next thing is to find out how much such material costs per unit. This task will be simplified if there is a cost system. If there is no cost system, reference may be had to invoices, the material identified, the price obtained and the unit cost for the operation under consideration obtained by a short "study." This study would consist of finding out how much material was necessary to turn out a given number of units, and after getting the price of the material dividing the total cost of same by the number of units produced. Using either figures taken from the cost records or the figures furnished by the study as a basis, the number of units in department No. 1 (24) may then be priced out at the material cost of $1.12, amounting to $26.88. The operation of labor may be taken either from a bill of prices or the cost records or a study similar to the one just indicated. In department No. 1, 24 units at 12 cts. per unit would give the labor cost of $2.88. If each department were to be considered separately and in the manner just suggested, the results would be found in the columns marked material cost and labor cost respectively. The figures in the column showing cumulative cost are the result of building up the unit costs by departments.

The basis on which the overhead is added is possibly more scientific than those which are frequently used. In the case under illustration, since there are eight departments, any goods in department No. 1 will be one-eighth completed, and any

Dept. No.	Units	Material	Cumulative Cost	Material Cost	Labor	Cumulative Cost	Labor Cost	F.		
1	24	$1.12	$1.12	$ 26.88	$ .12	$ .12	$ 2.88	1/8	=	3
2		.52	1.64		.14	.26				
3		.37	2.01		.08	.34				
4		.95	2.96		.06	.40				
5	32	1.15	4.11	131.52	.22	.62	19.84	5/8	=	20
6	64	1.13	5.24	335.36	.14	.76	48.64	6/8	=	48
7	80	1.22	6.46	516.80	.18	.94	75.20	7/8	=	70
8		.15	6.61		.27	1.21				
	200			$1,010.56			$146.56			200/141 .705

Material,....	$1,010.56	$1,157.12	
		.56	
Labor,......	146.56	$ 647.99	
		.705	
	$1,157.12	$ 456.83	= Overhead

Overhead,...........	$ 456.83
Material,...........	1,010.56
Labor,..............	146.56
Inventory,..........	$1,613.95

goods in department No. 5 will be five-eighths completed. If these figures are now reduced to a common basis for the purpose of getting an average, one-eighth of 24 will give 3 as a result, five-eighths of 32 gives 20, six-eighths of 64–48, seven-eighths of 80-70, a total of 141, which divided by 200, the total number of units, shows that product taken as a whole is 70.5% completed. The prime cost is made up of materials $1010.56 and labor $146.56. It is found by reference to the books in the previous period or to statements which are available, that the percentage of manufacturing overhead to prime cost in previous periods was 56. If the same thing were to hold true in this period the overhead would be 56% of $1157.12 (prime cost) or $647.99. Such is the amount which would be added to these goods in process if they had all been completed but they have not. They are only 70.5% complete so that 70.5% of this amount shows the correct amount to be added to the prime cost. The amount in question is $456.83. The total inventory value of the goods will thus be $1613.95.

The overhead is many times added through an arbitrary percentage. Someone will be of the opinion that 40 or 50 per cent, for example, should be added to cover the overhead. Where this has occurred it is advisable to examine into the basis suggested, question the person as to the foundation for the basis and the reason for his judgment. If the manager advocates 32 per cent he should be asked to explain why 32 per cent has been used.

From the above discussion of goods in process it will probably be seen that the rule to be followed by the auditor consists in ascertaining with regard to both goods in process and finished goods just what basis has been used in pricing the goods, and determining whether or not such basis is logical. From what was explained in connection with the goods in process, it will probably be possible to see what should happen in the case of finished goods. It would be a question of getting all the material, making a test, or rather making calculations concerning the material, labor and overhead.

Scrap should be reduced to the basic element or elements of which it is composed and priced at the market for same. The tendency with regard to scrap is to overvalue it, so that if any considerable quantity is involved the auditor should be cautious about accepting the values.

The auditor must also satisfy himself with regard to the extensions. The larger items may be tested. It is usually impossible, from a practical point of view, to attempt to check every item and the extensions of all the items in an inventory. Inventories are frequently very extensive. They sometimes cover hundreds of pages. Again, in this matter the auditor must ascertain how the extensions have been made. If they have been made by hand and by only one person, or in other words, have not been checked, the extent to which the auditor should go in his work would be considerably greater than if the calculations have been made by a machine and checked. Many concerns now have their inventories extended by comptometer operators. This is not only a means of great relief to the regular force but practically insures the accuracy of the calculations. Granting that the prices are properly set down, or furnished by someone who is accurate, there is little chance of an ultimate mistake existing. One person makes the calculation, a second performs the same operation, thereby checking the calculation.

If the inventory has been taken and machines such as Hollerith or Powers used in getting the results, they may usually be accepted as being correct. If the auditor is not satisfied with the results he will usually find that the cards are available and may have them put through the machine a second time, thereby getting results which may be checked with those originally furnished. The only possible mistake which may occur in the use of these machines is in punching of the cards. The chances of serious errors are rather remote.

With regard to the footing, there is not very much to be said. The only way for the auditor to satisfy himself in this respect is to go over the footings. If he has neither the time nor disposition to foot each column, he may cast them up roughly by glancing over the figures in the column and comparing them roughly with the result. He may of course take them off on an adding machine, but this will perhaps consume as much time as if he were to foot them as they stand.

It may not be out of place to mention, in connection with this topic, two articles which appeared in the *Journal of Accountancy*. They are entitled "The Relation of the Auditor to Valuation of Inventories," by W. Ernest Seatree. The first appeared in the September, 1914, number; the second in the November, 1914, number.

CHAPTER XVII

Analyzing Accounts

A great deal of the footing of the general ledger accounts may be avoided if the accounts are analyzed. By analyzing an account is meant taking it apart and classifying the component items so as to get an idea as to what the account contains. It will probably be seen that if an account is taken apart and the items are grouped according to the different classes of things which they represent and the totals of the groups are added, a proof on the account will be obtained without footing the items as they appear therein.

Aside from proving the additions in general ledger accounts, analysis has four practical objects: first, to see that nothing has been buried; second, to see that nothing has been charged to the wrong account; third, to see that expenses have not been capitalized; fourth, to see that assets have not been carelessly written off.

The word "bury" may sound like slang, but it is not. It conveys considerable meaning in accounting. It is almost a technical term so far as accounting is concerned. It means something hidden, covered up, lost sight of.

Again, something may be charged to the wrong account through error. It may be nothing intentional on the part of the bookkeeper; merely a mistake in getting it into the wrong account. It may occur because of an error of principle; doing it because he does not know any better, or as a mechanical error; putting it into one account when he intended to put it into another.

Very often expenses will be found charged to asset accounts. This has the effect of capitalizing them. Such is more apt to be the case where a concern is running behind; the profits are not as large as they have been, or it was hoped they would be; or there is an operating contract with the manager or superintendent whose compensation depends upon the profits. There is always more or less of a struggle going on between the administration and the management. The manager is inclined to attempt to capitalize everything possible in order to keep down the ex-

penses and increase the profits. The administration, on the other hand, is exercising vigilance constantly in order to prevent the capitalization of expense.

Concerning the fourth class, there is a tendency on the part of many concerns and individuals to write off promiscuously thoroughly good assets because there is in their opinion some question about when or how they will be used up. Such concerns or individuals are anxious that nothing shall appear in the list of assets which is not absolutely sound and has a "convertible value," as it is sometimes expressed. Anything like chairs or small fixtures that are liable to become broken, lost or stolen, are in such cases charged immediately to expense without any consideration. Frequently these things are carried to extremes, sometimes intentionally and sometimes ignorantly. In a recent case which came to attention, several thousand dollars worth of furniture was charged to expense when purchased because it was argued that the furniture would wear out in a short time, the concern could afford it and therefore it was the easiest way of disposing of the matter. Such argument and procedure may be quite proper but it appears to open the way and make easy, crookedness where it might not otherwise appear. If employes know that things of such character are charged off and lost sight of, there is no reason why they may not help themselves to things which may be carried away, especially if no record of such articles is kept.

The four things above mentioned would not be brought to the attention simply through the mechanical work of checking. Checking would not disclose anything buried. It is not probable that it would disclose anything charged to the wrong account. There may be, however, an exception to this statement. If, for example, the bookkeeper is posting to the furniture and fixtures account and such account in the ledger appears on page 54, he may inadvertently turn to page 56, there make the posting and note the posting reference in the appropriate column in the voucher record as page 56. The item has obviously been posted to the wrong account. It will be found on page 56 of the ledger and 56 will be marked on the voucher record, so that whether the auditor checks from the voucher record to the ledger or from the ledger to the voucher record he will find an entirely good posting from page 56 and the opinion may

be ventured that in many cases the mechanical checking would not disclose the error. If perchance the bookkeeper notes in his voucher record 54 as the page to which he intends to post the item and then posts it to page 56, such an error would undoubtedly be caught in checking. This illustration of course raises a question with regard to the technique of checking, as to whether or not the auditor in checking should observe the title of the account affected rather than the pages. It is of course true that the ideal manner of checking is one which takes into consideration the accounts affected as well as the amounts. The page numbers theoretically serve only as a means of assistance in finding the proper accounts. Practically, when a person settles down to the humdrum of checking, the page numbers are probably more apt to serve as a guide to the amounts only rather than the titles. While this argument of course departs from the ideal it recognizes the weakness of human nature when involved in work of this kind. It requires an unusual man to glorify work of this nature to the point where every bit of it will be done thoughtfully. Many begin this work with good intentions. It is safe to say that most of these fall into the same rut and after a short space of time has elapsed do this work in the same old mechanical way. It is more apt to be done well if done by two persons rather than one, since one calls and the other checks.

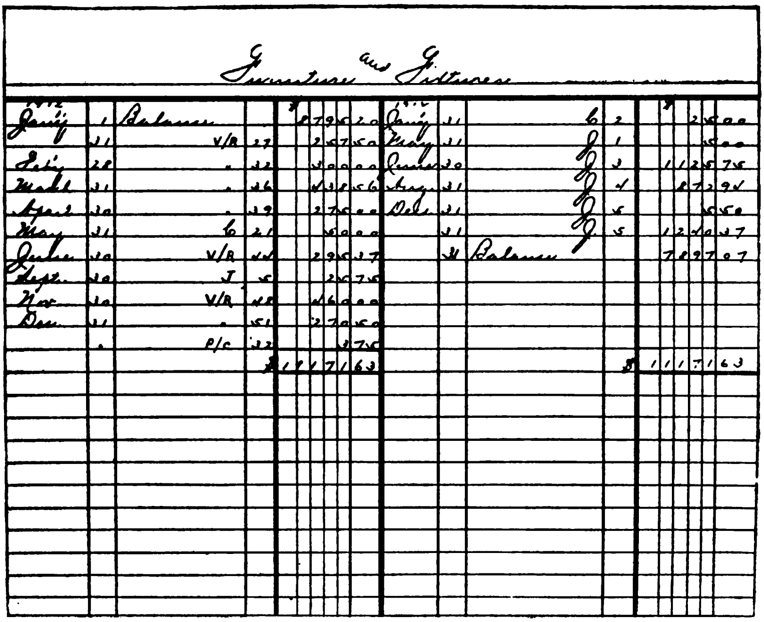
Analyzing accounts is a part of the work which may not be too carefully done. Above all the results must be comprehensive and clearly expressed. The amount of time involved in making an analysis is usually considerable. If the results when obtained are not clear and understandable and do not permit of use the time has been wasted.

It may be interesting to have the procedure involved in analysis given first, to be followed by a typical case which will be worked out.

Analysis paper should be used. It should be headed up with the name of the organization, the period covered by the work and a statement to the effect that it is an analysis of such and such an account. One sheet (or more if necessary) should be used for the debits and one sheet or more for the credits unless it is quite obvious that both debits and credits will go on one sheet. One may frequently be deceived about this and it is

probably safer always to take a separate sheet for debits and credits. Beginning in the upper left-hand corner in the first column, the date should be provided for; in subsequent columns the posting references and amounts. After the amount there should be noted any explanation which may appear in the ledger account.

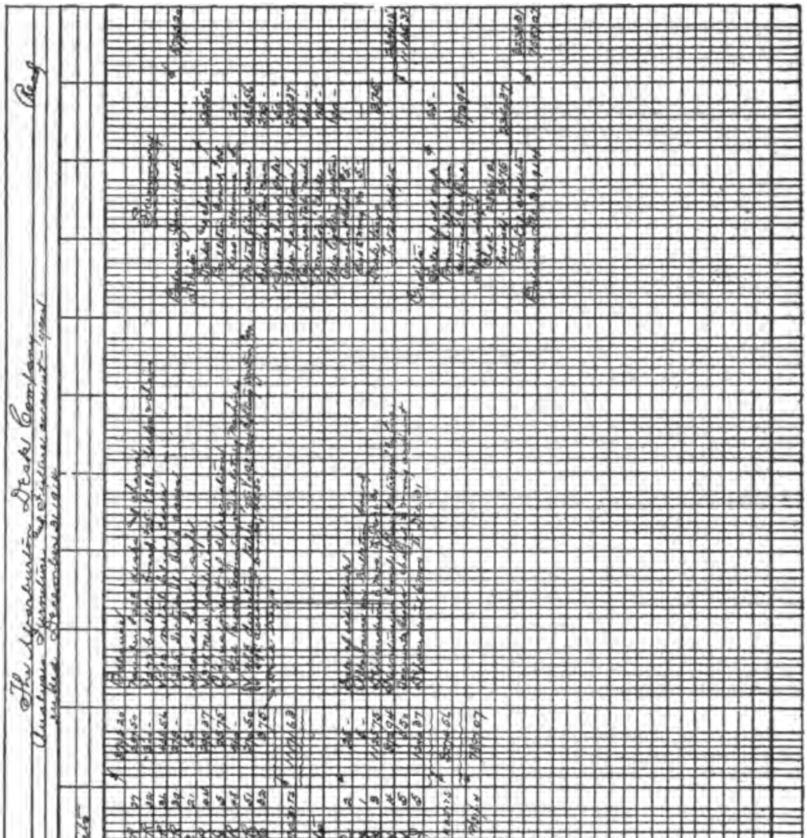
In the illustration about to be presented especially the transcript of the ledger account and the analysis, it should be remembered that one is not asked to pass on the propriety of the account or the items therein but rather to observe the technique involved in analyzing the account. The ledger account is first presented as below in order that each step in the process from beginning to end may be observed.



Furniture and Fixtures

1912						1912				
Jan'y	1	Balance			$ 8795 20	Jan'y	31		G 2	250 00
	31	V/R	27		257 50	May	31		J 1	50 00
Feb'y	28	"	32		300 00	June	30		J 3	1125 75
March	31	"	36		438 56	Aug.	31		J 4	872 94
April	30	"	39		275 00	Oct.	31		J 5	55 50
May	31	G	21		50 00		31		J 5	1240 37
June	30	V/R	44		295 37		31	Balance		7897 07
Sept.	30	J	5		25 75					
Nov.	30	V/R	48		460 00					
Dec.	31	"	51		270 50					
	"	P/C	32		37 50					
				$	11171 63				$	11171 63

Assuming now that a sheet of analysis paper has been headed up, starting in the upper left-hand corner, a transcript of the ledger account should be made. In this case one sheet of analysis paper will suffice, since the debits and credits will all go on one page. Reference to the illustration which appears below will show the first three columns devoted to the dates, references


Debits

Credits

Summary

and amounts. It should also be noted that care has been observed in stating not only the total debits and the total credits, but in showing clearly the balance in the account as it appeared in the ledger account.

Little matters like bringing the balance out clearly as above mentioned may not seem important. When the time comes, however, to use the figures it may be long after the analysis is made. Little points like properly bringing out the balance in the ledger account may either greatly facilitate or hinder the work at the time the figures are "put together." Not long ago in going over a report a skeleton ledger account appeared to show a balance of $45,000. The books from which the figures were taken were not available and it was necessary to take off a trial balance of the skeleton ledger which had been built up from the cash book before being able to tell whether the account should show a balance or not. Half an hour of the time of a busy man who was engaged in writing comments was required in taking off the trial balance of the skeleton ledger in order to determine whether the balance of $45,000 was open or not. When upon completing the work it was found that the debits exceeded the credits in the amount of $45,000, the conclusion was that the account had been closed. This expense of time and annoyance was caused by careless work on the part of an assistant who did not realize the importance of careful attention to details. In just such ways as this, hours of time are wasted by accountants. The man who put the figures together in a report wants to be sure when he picks up an analysis that he is using the proper figures. He must know that the figures are the same as those in the books; that the difference between the debits and credits which he is using is the same balance as that for the particular account in question in the trial balance.

Assuming now that the transcript of the ledger account has been properly made on the analysis paper, the next step is to find out what each one of the items represented therein means. Explanations of postings sometimes appear in ledger accounts. In such cases they should be jotted down when making the transcript, but should serve only to indicate the content of the account. It is probable that the tendency to-day is away from showing explanations in the ledger. Sometimes in simple ac-

counts it is practicable to give complete explanations for each item. Usually, however, the postings are made at the end of the month and may represent a considerable number of items and variety of things. It is of course ideal when the complete story contained in an account may be read from the explanation columns. It will probably be an exceptional case, however, where this will be possible. In the transcript of the account appearing above the first item appearing is the balance in the ledger account for furniture and fixtures. In a property account such as the furniture and fixtures account is the balance should be traced back into previous ledgers if possible and analyzed. On the first engagement this is essential. On subsequent engagements it need not be done of course.

Taking up next the second item of $257.50 it will be necessary to find out what this amount represents. Assuming there is no information on the face of the ledger, which at best would serve only as a guide, it will be necessary to go back to the book from which the entry was made. The book in this case is the voucher record, page 27. The term voucher record is used here as synonymous with the purchase journal. Turning to page 27 of the voucher record it will be found that this page shows the footings for the month of January where the book will probably have been ruled off and the totals for the month of January inserted. Hunting out the column for furniture and fixtures, if there is one, there will be found at the bottom of the column the amount of $257.50. Tracing up the column there will be found on a certain line the same item of $257.50. Following then across the page to the left on this line the voucher number will be discovered. It will next be necessary probably to "pull the voucher" as it is called, or have the voucher "pulled." Usually a list of the vouchers that are wanted is given to the bookkeeper or clerk who has charge of them and the vouchers are gotten out. Having obtained the voucher in the amount of $257.50, it may be found upon examination to represent the purchase of desks and chairs. The next step consists in noting on the analysis sheet to the right of the amount —$257.50, the explanation, namely, "desks and chairs" together with the voucher number, for example, 233.

In certain instances items for furniture and fixtures, for example, will occur so infrequently that it will not be thought

necessary to provide a column for these items. If this is the case, it would be necessary to hunt through the general ledger column in the voucher records and pick out the items representing furniture and fixtures.

The next item of $300 will be found on page 32 of the voucher record. This will be the footing for February, and finding the column for furniture and fixtures it may be followed up until the first item is found. It is possible a better way would be to turn back to the beginning of the month and having found the furniture and fixtures column, follow it down until the first item is reached. In this case the first item may be found to be voucher No. 273, which upon inspection will show that the amount covered a bulletin board—$25. Continuing on down the column the next voucher may be No. 286 and will be found to represent more desks and chairs in the amount of $275. This information may then be carried to the analysis sheet and jotted down in the appropriate place. Subsequent items as they appear in the ledger account will be found explained on the analysis sheet. It is not thought necessary to follow through the procedure in each case, since it has in two instances been explained and illustrated. Up to this point it will be noted that no consideration has been given to the content of the account whether right or wrong. The work has consisted entirely of noting facts.

On one of the sheets of analysis paper, if more than one is used, and preferably the top sheet, there will usually be room at one side where a summary of the analysis may be made. This is necessary in order that one may look at the analysis and see at a glance what the account contains without having to go through it item by item. The summary will be found in this instance on the analysis sheet. Where the account is extensive and a number of pages are required for the items, or where the summary is extensive, the summary should be placed on a separate sheet which will go on top of the others where it may be readily seen.

The information concerning the furniture and fixtures account is now in such condition that when the time for preparing the reports arrives, one may see at a glance what is in the account. This person may be the one who made the analysis or someone else. The information contained in the summary may be scrutinized and discussed with regard to the propriety of the

entries and the propriety of the items with special reference to discovering whether anything has been buried, charged to the wrong account, expenses capitalized or assets carelessly written off. A person looking at this summary has the story of the account before him in crystallized form. It would be appropriate at this time to consider whether or not the old desk sold for $25 should be credited to this account in the amount of $25; also whether the amount representing branch office furniture destroyed by fire is on the basis of cost or the amount in which the claim against the insurance company was settled. With regard to depreciation, the value of the summary might have been enhanced somewhat if the man who made it had shown the basis on which the depreciation was calculated. With reference to this particular analysis it would appear that everything in the account is regular, that there is nothing out of proportion and nothing to attract undue attention or cause undue investigation.

In order to check the figure for depreciation, an analysis of the balance at the beginning of the period would have to be made unless this had been done in a previous audit and the information was available. The depreciation it will probably be seen is based not only on furniture and fixtures purchased during the present year but that which came over from a previous period. Time being an element in the calculation of depreciation, the length of time which the respective articles of furniture have been in use will have to be ascertained. This work may sometimes be facilitated by an underlying book kept by the client in which the details of property accounts are shown. If no such book is kept it is probable that the bookkeeper or company accountant will have retained the figures on which the calculation was based.

In the matter of analysis the question which frequently arises, is how many and which accounts should be analyzed. In answer to that question it must be said that it is not considered necessary nor is it customary to analyze all the accounts. This work should be applied particularly to the property accounts and expense accounts of any size. Irregularities are more apt to be found in property accounts and in expense accounts than in others. The other accounts, at least most of them, will be checked out automatically in the course of the work.

CHAPTER XVIII

Some Accounts Which Require Analysis

After the work on the inventories has been completed the trial balance should be gone over, account by account, analyzing or checking up such accounts as need attention. If reference is made to the specimen trial balance previously presented, the first account will be seen to be land and buildings.

The land and buildings account should be analyzed. This should be done not only on account of the four usual reasons for analysis but also to determine how much of the account represents land and how much buildings. It is frequently desirable to have this information in order to determine whether or not the insurance is adequate. In a mixed account like land and buildings it is impossible to form any judgment on this point unless the two factors in the account are separated. An account for land and buildings as it appears on the books may show a balance of $187,000. It may also be ascertained that insurance is being carried to the extent of $80,000. Before one can say definitely whether or not $80,000 is adequate, the extent to which buildings are represented in the $187,000 must be known. It is likewise necessary to have information on buildings in order to calculate or check the depreciation.

The analysis of the land and buildings account should show with regard to land, the purchase price of the original parcel plus any improvements, such as filling in, grading, laying out streets, curbing, guttering, laying of sidewalks, setting out trees, etc. There should also be shown, the sales of any part of the land, and the auditor should ascertain whether any credit representing a sale is on a cost or selling price basis. It not infrequently happens that when land is sold the selling price is credited to the land and buildings, or the land account, as the case may be. Since the selling price includes the profit such procedure is doubly detrimental. It not only fails to show the profit but it has the effect of applying the profit to the reduction of the asset. What should be done, of course, is to find out in terms of square feet of acres, how much land was purchased and obtain the cost per square foot or acre. If any part of the land is sold the number

of square feet or acres should at cost be credited to the land account while the difference is credited to profit and loss or to surplus.

A request should be made to see the deed to the property and the title insurance policies. This is also as good a time as any to ask for the tax receipts. It is also well to note on the working papers showing the analysis of the account, the fact that the deed, title insurance policies and tax receipts have been seen. Taxes should be distinguished from assessments. Taxes may not be capitalized and should not appear in the land account, whereas assessments may with propriety so appear. Assessments may cover such things as removing cobblestones and replacing them with modern paving, putting in sewers or water systems and the like. All these things constitute improvements to the property and may be charged to the land and buildings account. In New York City assessments are being laid for certain branches of the subway system and there is probably no doubt about the propriety of capitalizing such assessment since the property along the subway routes will benefit accordingly.

An interesting problem with regard to assessments recently came to notice. A certain institution had during a period extending as far back as 1868 sustained assessments which amounted to $30,000. The institution had been contending against these assessments on the ground that it should be exempt under certain privileges which the law extends to educational, religious and other eleemosynary corporations. The efforts to have these assessments abated not having been successful the institution put the claims into the hands of a lawyer who makes a specialty of getting abatements, with the understanding that if he succeeded in this case he should receive ten per cent. The lawyer was successful and earned $3,000. The question which was presented to the author was this, "Shall we capitalize the $3,000 or charge it to expense." The question is undoubtedly a trying one. The assessments if sustained would have constituted a bona fide addition to the cost of property. On the other hand, the services of the lawyer were without question expense. The expense, however, was incurred in saving a capital disbursement of $30,000 and consequently takes on a capital appearance. The solution which was suggested was in the nature of a compromise. While perhaps not so stated by the institution it

was apparent that one of the principal points of objection was the necessity of including an item of $3,000 in the operations of one year, while the expenses were in connection with having assessments abated which extended back forty-five years. The suggestion was therefore made that the amount of $3,000 be set up on the books and written off over a period of ten years.

The other part of the land and buildings account about which nothing has yet been said is that representing the buildings. This should consider the original purchase price of the buildings plus any additions or betterments. In lieu of the purchase price there may appear payments on account of building contracts. The account may also show credits for sales of parts of the buildings and possibly credits for depreciation. It is of course important to be on the lookout for repairs which have been capitalized.

Regarding the insurance on buildings the auditor should bear in mind that unless property is insured for eighty per cent of its value, the holder of the policy becomes a co-insurer to the extent of the difference between eighty per cent of the value and the amount at which the property is insured. There are different kinds of policies and of course policies in which full value is received in case of a total loss. For such policies an increased premium is paid. It is probable, however, that the majority of policies are written with what is called the eighty per cent clause. While it would seem that all owners of property should be familiar with matters of this kind it sometimes happens that they are not.

In a number of accounts which follow it is not thought necessary to go into all the details concerning them. The procedure laid down in the preceding chapter together with the explanation in connection with land and buildings should, it seems, serve sufficiently as a guide. The other property accounts especially, are the same in their nature as the land and buildings account and may generally be treated in the same way.

The account for machinery and tools should be analyzed and inquiry made as to whether or not the account contains items of such equipment which are obsolete; also the extent to which the account represents small tools which are subject to loss or destruction, in order to compare the book value of such tools with the physical inventory of same.

Another account which should be included in the work of analysis is the account for horses, wagons and motors. It seems almost unnecessary to say that the analysis should show the component parts of the account, that is to say, how much represents horses, wagons and motors respectively. Where the units of equipment are so easily separable on account of their size an attempt should be made to identify the equipment by units and make it possible to compare the physical property with the book record. It is also important that the date of purchase of these units should be carefully set out so that depreciation may be calculated or checked.

Furniture and fixtures should be analyzed. More difficulty will probably be experienced in connection with this account than in any other in identifying the units. While it is true that the units may be fairly large it is not probable that the book records will enable one to distinguish between expensive and inexpensive units.

Securities owned may next be taken up. The extent to which the account represents stocks, bonds, bonds and mortgages and miscellaneous securities should be ascertained. In many instances provision for this separation will be made in the ledger by keeping the respective accounts and the title "securities owned" will only be used in the balance sheet. It is quite usual, however, to find all securities appearing in one general ledger account. It is to be presumed, of course, that the securities were examined and listed at the time the audit was begun so that at this point after having ascertained the aggregate of the respective factors in the account the result of the count should be compared thereto class by class. At this time there should also be covered the matter of checking up verifications which have come in as a result of requests sent out at the beginning of the audit on account of securities which may have been out for various purposes, such as collateral, etc. The question of valuation is not one which arises at this time. It should be taken up rather at the time of preparing the balance sheet and writing the comments.

Treasury stock, if such an account appears, should be looked into with the view of ascertaining just what the conditions surrounding the account really are. The thing to be determined is whether or not something so-called is treasury stock. The discussion with regard to this matter will depend upon the theory

which the auditor holds concerning treasury stock. Whether or not it has been properly handled on the books in question will be determined by the auditor through a comparison of the manner in which it has been handled with his own idea as to how it should have been handled. Since there are conflicting theories on this point it behooves the auditor to make very sure of the ground on which he argues. The suggestion is made that there is but one safe theory concerning treasury stock. Stock which has been once issued for value and subsequently acquired should be so considered. Stock which has not been issued should never, in the opinion of the author, be considered as treasury stock.

Patents, trade-marks, copyrights and good-will may all be included in one account. Again the discussion as to whether or not they have been properly handled will depend upon the theory which the auditor holds concerning each item. The account should be analyzed in order that there may be set forth the amount representing patents, trade-marks, copyrights and good-will, respectively. Wrong treatment is perhaps of no more importance than the fact that they have all been thrown in together. The auditor should know the period for which the patents, trade-marks or copyrights are issued and be guided accordingly in deciding whether or not such items have been properly handled. There are so many conflicting theories concerning good-will that it does not seem wise to lay down any rule for same. Having analyzed the account and found out the amount which represents good-will one must be guided by the circumstances in the case and decide whether or not the manner in which the good-will has been treated is logical and conservative. Information will sometimes be found in the records, or in the minutes, or some contract which will satisfy one as to the figure at which the good-will is carried. This may at times be supplemented by the opinion of some official who is qualified to pass judgment on the matter or to explain the basis upon which the value was set up.

CHAPTER XIX

The Customers' Ledger

The auditor may either take a trial balance of the customers' ledger or check the one furnished. In the majority of cases it is probable that the trial balance of the customers' ledger will be furnished. It is also probable that in most cases the auditor will check the one furnished rather than take off his own. Nothing seems to be gained by making a new trial balance. Such procedure was advocated in the case of the general ledger because the time consumed in so doing offered an opportunity to study the business. The situation with regard to customers' accounts is different. One customer's account is like every other customer's account in its relation to the organization, consequently no benefit seems to be derived from taking off a new trial balance. On the other hand, a great deal of time is saved, especially if the accounts are numerous, in using the one furnished.

The information being sought with regard to the customers' accounts is whether or not the ledger containing the details is in agreement with the controlling account and whether or not the accounts are worth their face value. On the first point the auditor may assure himself by taking or checking the trial balance of the customers' ledger. The determination of the second point is somewhat more difficult. In order to assure himself concerning this matter he must endeavor to ascertain whether or not the indebtedness as shown is admitted by the customer as being correct and get the opinion of someone qualified to judge as to whether or not the amounts shown will be collectible in full.

In order to determine whether or not the indebtedness as shown is bona fide and correct, it is customary to send out some communication to the customer and obtain his acknowledgment as to the balance. This may be done in one of several ways. One way is to have the monthly statements turned over to the auditor to be checked by him and sent out direct. It is important that the statements should not fall into the hands of the employes of the client before being sent out but should be inserted in the envelopes and sealed immediately after being checked.

It is also important that upon their return statements should reach the auditor without being opened. This is sometimes accomplished by having the statements mailed to the auditor's business office. Objection to this procedure is sometimes made by the client in that it draws attention to the fact that his accounts are being audited. This, in the light of present-day publicity, does not seem to constitute a valid objection. It is, however, an objection which it is not always possible to overcome even with tact and has to be endured. Where such is the case the auditor is usually able to arrange to have such statements returned in envelopes which may be identified and which will be presented to him immediately they are received in the client's office.

It is customary for the auditor to have affixed to statements before they are sent out, a notice of some kind, to the effect that the information is required for the purpose of verifying the balance. The content of the notice which is usually affixed by means of a rubber stamp takes two forms. One is that of a positive verification. The other is that of a negative verification. These verifications are in substance as they appear below:

> Please verify the above balance and report at your earliest convenience to John R. Wildman, Certified Public Accountant, 32 Waverly Place, New York City.

> Please examine immediately. If not correct, please address New York University, Division of Applied Accounting, Washington Square East, New York, stating difference.

Another method of obtaining verifications is to send out with the statement a form letter with a perforated form attached, requesting the customer to verify the balance and report on the blank form provided. A specimen of this form as used by Haskins and Sells follows.

Form No. [illegible]

WATERTOWN
BALTIMORE
PITTSBURGH
CLEVELAND
CHICAGO
ST. LOUIS
ATLANTA
DENVER
SAN FRANCISCO
LONDON, E. C.

HASKINS & SELLS
CERTIFIED PUBLIC ACCOUNTANTS
30 BROAD STREET
NEW YORK
CABLE ADDRESS "HASKSELLS"

DEAR SIR:

In connection with our audit of the books and accounts of ____________________, we are sending herewith their statement of your account with them covering the inclusive period from ____________________, and shall be obliged if you will examine it and advise us on the attached form of its correctness or of any exception you may find to take thereto.

Stamped and addressed envelope for your reply is enclosed.

Yours truly,

APPROVED: ____________________

____

....

____

No. __________

MESSRS. HASKINS & SELLS,
Certified Public Accountants

DEAR SIRS:

I have examined the statement received from you of my account with ____________________ covering the inclusive period from ____________________ and find it* ____________________

____

____

____

____

____

Yours truly,

____

*Insert the word "Correct" if you so find the statement.

All of these devices are at best unsatisfactory. It is a difficult matter to obtain verifications of all balances. It is probably within reason to say that at least one-third of the customers will pay no attention to the request, thereby making a complete verification impossible. The larger balances should be followed up with a second or third request if necessary. The positive

verification seems preferable to the negative. The latter, however, does place the burden on the customer and results in a considerable saving in time in so far as the auditor is concerned.

In the matter of satisfying himself with regard to the probability of collection of the accounts the auditor is usually compelled to rely on the judgment of the credit man or some representative of the client who is in a position to state as a result of his experience with the concern whether or not the respective accounts will be collected. In accomplishing this the auditor goes over the accounts one by one with the credit man, for example, who gives his opinion with regard to each account as to whether it is good, doubtful or uncollectible. By classifying the individual accounts in this way the auditor is enabled to ascertain with regard to the accounts as a whole the extent to which they are respectively good, doubtful, or bad. In case there is no credit department there will usually be found in the employ of the client someone who will perform this function of the credit man.

A valuable means of supplementing the opinion of the credit man, which it must be said is not always as unbiased as it might be, consists in ageing the accounts. This takes the form of analyzing each balance or determining with regard to the balance in the account how long it has been outstanding, and classifying the balance with regard to the length of time it has been outstanding. In some cases the time may be classified as thirty days or less, sixty days or less or more than sixty days. Circumstances in different cases will of course dictate different periods of time. If goods in a particular case are sold on a six months' basis, the thing of interest is to find out how many of the accounts are over six months old. In such a case the periods of time might be six months, nine months and a year.

Ageing the accounts is an expedient which is especially helpful to the auditor in enabling him to judge independently as to the value of the accounts receivable and the adequacy of the reserve for bad and doubtful accounts. If an account which should have been settled within thirty days has been outstanding two or three years, the chances are that said account is not a perfectly good account even though so considered by the credit man. Some credit men are capable and honest and give an absolutely unbiased opinion. Others, while honest, may not

have all the facts as to the accounts, or may fear to give a frank opinion concerning certain accounts because of the unfavorable showing which may result. Credit men have been known to classify certain accounts as good when the concerns in question were in the hands of receivers and there was no probability that more than ten per cent of the amount involved, for example, would be received. Having aged the accounts the auditor is not obliged to rely on such opinions. He has a definite basis for his own judgment.

In order to make clear what is meant by ageing the accounts an illustration is presented below. There is first given an outline of the schedule, followed by a number of customers' ledger accounts. The schedule should be made on analysis paper, providing for the ledger folio, name of the customer, amount and classification according to the periods of time.

Trial Balance, Customers' Ledger, December 31, 1914

L.F.	Name	Amount	30 days	60 days	Over 60 days

Sheldon & Willis

1913			1914		
Nov. 13,	S—32	$47.50	Jan'y 4,	C—2	$47.50
Dec. 8,	S—47	18.37	March 25,	C—18	18.37
1914					
March 28,	S—84	52.74			
July 14,	S—122	15.96			
		$134.57			$65.87
	(68.70)				

Clarkson & Company

1914			1914		
Oct. 14,	S—173	$15.43	Nov. 2,	C—27	$15.43
Nov. 24,	S—185	5.81	Dec. 5,	C—32	5.81
Dec. 13,	S—194	4.62			
		$25.86			$21.24
	(4.62)				

S. Merrick

1914			1914		
Jan'y 1.	Bal.	$753.27	Feb. 2,	C—10	$27.45
" 31,	S—52	27.45	June 9,	C—21	425.00
June 7	S—115	225.00	Oct. 5,	C—25	172.43
Oct. 5,	S—170	172.43			
		$1,178.15			$624.88
	(553.27)				

Hoyt & Stetson

1914			1914		
Aug. 3,	S—151	$31.86	Aug. 27,	C—20	$29.43
Sept. 17,	S—165	16.52	Oct. 5,	C—24	16.52
Oct. 14,	S—173	19.43	Oct. 29,	C—25	19.43
Nov. 29,	S—187	27.18	Dec. 4,	C—32	27.18
Dec. 15	S—195	15.75	Dec. 24,	C—34	15.75
		$110.74			$108.31
	(2.43)				

In the accounts as they appear above the first one is that of Sheldon & Willis. It shows debits in the amount of $134.57; credits $65.87; balance $68.70. Assuming that the date at the end of the period covered by the audit is December 31, 1914, if an attempt is made to classify the balance with regard to age, it will be seen that it is over sixty days. The first entry may now be made in the schedule showing ledger folio #1—Sheldon & Willis—$68.70, the latter to be entered first in the amount column and subsequently in that marked "over 60 days." If the same procedure is followed in the case of the other accounts the schedule will then appear as below.

Trial Balance, Customers' Ledger, December 31, 1914

L.F.	Name	Amount	30 days	60 days	Over 60 days
1	Sheldon & Willis	$68.70			$68.70
2	Clarkson & Co...	4.62	$4.62		
3	S. Merrick......	553.27			553.27
4	Hoyt & Stetson..	2.43			2.43
		$629.02	$4.62		$624.40

The study of customers' accounts is a very interesting one. They will at times reveal a great deal. That of S. Merrick as presented above illustrates one point in this connection. The account is shown as having an old balance, just how old of course is not disclosed. Notwithstanding this balance more goods were sold to him on January 31 which it will be seen he paid for very soon. On June 7 still more goods were sold to this party. He not only paid for the invoice of June 7 but included in his check something to apply on the old balance. The story told by this account is that of an old balance being reduced. It is a hopeful sign and indicates good intentions on the part of the customer. Consequently with indications of this kind one should be cautious about classifying the account as doubtful.

It is well that all transactions of every description should be put through a customers' account. Sometimes in the case of a customer, such as Merrick appears from the account to have been, checks will be received for current invoices which when presented for collection are returned marked "no funds." In a case of this kind the check should be charged back to the account so that the account will show the full history of the customers' relations to the house. This would also call for a record of any notes which went through the account and which should be charged back to the account if not paid at maturity. It also seems desirable that a notation should be made at the top of each account of the number and amount of customer's notes which are being carried since it is the credit relation which is usually desired in connection with a customer. Whether this is represented by accounts or notes is not so important as to know the total amount of indebtedness. It is also desirable to have such information all in one place.

In the case of Hoyt & Stetson it will be seen that the balance of $2.43 is an old one. The indications are that it is a disputed claim. In a case like this whether it be over sixty days or over a year makes little difference. The important thing which is brought out is the fact that the item is in dispute. An opportunity is thus afforded to investigate the matter and have it adjusted in some way. Such is one of the additional advantages of ageing the accounts, namely, the bringing to the surface of all differences which require adjustment and which are frequently allowed by bookkeepers to drag on indefinitely when they should be closed out.

CHAPTER XX

Other Accounts Which Require Attention

Drafts and notes receivable come under this heading. A list of these will probably have been made at the time when they were counted or examined. If this has not been done, a list should be made. The total of such count or list should agree with the balance in the ledger. Cognizance will have to be taken of the accrued interest on notes receivable and drafts, but this work will be facilitated if postponed until after the interest account has been analyzed. After the analysis of the interest account, the auditor is in a position to check or accrue the interest in each case.

An account is sometimes found which bears the title "subscribers to capital stock." In this connection the auditor should ask for a list of the subscribers, showing the amount of the original subscription, the amount which has in each case been paid and the amount remaining unpaid. It will not be necessary to ask for a list if it so happens that the number of subscribers is sufficiently large to warrant opening a ledger for such accounts. This not infrequently happens. Where such is the case it will be a matter of taking a trial balance of such ledger and agreeing the total with the amount in the general ledger. In the same way the total should be agreed in the case of a list. As to the balances in the individual accounts, the auditor should assure himself that they are bona fide and not simply dummy balances which are being carried. An account with John Smith may show that he subscribed originally for ten shares of stock—$1,000; that he paid the first call, or the first instalment, 25%, $250, and that the balance is $750. It may appear in the ledger as a good balance but upon investigation may develop that Smith has refused to make subsequent payments and has in fact forfeited his right to the subscription or to the stock.

With regard to sinking funds, reference should be had to the indenture which provides for the sinking fund. By indenture is meant the mortgage. This should be scrutinized in order to see what the terms are and who the trustee or trustees are. If the sinking fund is involved there will be found in the mortgage

a sinking fund clause which will usually set forth all the facts concerning it; that is, how much of a sinking fund is to be provided, when the amount is to be set aside, the basis on which it is to be calculated, sometimes the depositary and who the trustee is to be. It is obvious that the auditor may not proceed intelligently without having all of these facts at his disposal.

Having ascertained where the fund is on deposit, perhaps through the courtesy of the trustee as it were, if the trustee is other than the depositary, a certificate should be obtained as to the amount of deposit and a statement covering any interest recently credited. The procedure here is the same as that in verifying a bank account. A request should be sent out to the depositary. Each request should bear the approval of the trustee. The amount of deposit should agree with the amount shown by the ledger account in the books of the client. Frequently the depositary will have credited interest on the sinking fund deposit which will not yet have been reported so that it may be necessary to take such interest into consideration in effecting the reconciliation.

Subsequent to the reconciliation the amount of the sinking fund should be verified in accordance with the terms of the sinking fund provision. It sometimes happens that while the account of the depositary will agree with the books of the company, the amount of the sinking fund will not be as large as it should be under the terms of the sinking fund agreement. Cases have been encountered where the company has made a certain number of payments to the sinking fund and then ceased making payments. This would not be disclosed by a certificate. The account should be checked through from the beginning to the end and verified chronologically. This verification may involve in certain instances the detailed calculations such as in the case of mining companies where the amount of the annual or semi-annual sinking funds deposits depend upon the tons of ore mined.

The sinking fund may exist in the form of cash in hand or on deposit, or securities which have been purchased out of sinking fund deposits. If the trust company in which the sinking fund has been deposited says only 2% on daily balances, or 3% on time deposits, the trustee may be subject to criticism, unless his duties are prescribed and restricted, if he does not

invest the funds in securities which will yield a higher return. Gilt-edge securities to-day will yield 3½% and 4% and not much difficulty is experienced in finding such securities.

Trustees who are permitted to invest funds in securities as soon as the fund accumulates sufficiently, sometimes prefer and sometimes are so required to purchase outstanding bonds of the company which makes the deposit. It is frequently argued that such bonds are the best possible investments. Since the object of the sinking fund is as a rule to redeem an issue of outstanding bonds it seems that such procedure is not only proper but expedient and economical. If a company has an issue of bonds outstanding on which 5% interest is paid, and on the other hand, is depositing funds at 3% for the purpose of redeeming such bonds, it seems unbusinesslike if the bonds may be purchased at a reasonable figure to allow them to remain outstanding. Purchasing bonds results in shutting off the interest and a saving equal to the difference between the interest received on the deposit and the interest paid on the bond, having regard, of course, for any premium which may be involved in the purchase. Under such circumstances the sinking fund may be found to exist in the form of cash, outside credits or the company's own securities. Here, a certificate as to the cash should be obtained and the securities either examined, which is of course the best method of verification, or a certificate obtained from the trustee as to what securities he is holding for account of the fund.

Securities of the company may either be cancelled or kept alive. If they are cancelled the interest stops and they are returned to the company. If they are kept alive the trustee treats them as outside securities and collects from the company whatever interest attaches. The situation in this respect must be taken into consideration by the auditor later when he reaches the point of setting up the balance sheet. If the bonds have been cancelled they should, it seems, be deducted from the outstanding bonds on the liabilities side and the net amount outstanding be shown. If they have not been cancelled, they will have no effect on the liabilities and will be carried along and considered as a part of the sinking fund. Here, again, the opinion of the auditor may depend upon the theory which he holds. Whether the action of the company is right or wrong in his opinion must be determined by comparing such action

with what he considers to be right or wrong, and such consideration will depend on what his theory is. It is thus apparent that before the auditor offers any criticism of the method, he should be very sure as to facts and have a definite idea as to his own theory.

One further point should be mentioned before leaving the subject of sinking funds. This is the necessity of reading carefully and trying to understand the intent of the provisions with regard to the creation of the sinking fund. The wording of mortgages in this respect is not always as clear as it might be. It is sometimes difficult to determine just what was intended. One way of setting up the accounts in connection with the sinking fund is to make a charge to profit and loss and a credit to a reserve for the amount involved subsequently funding the reserve by transferring the amount from the general cash to the sinking fund cash. The other way is to ignore the charge to profit and loss and the credit to the reserve and transfer the amount from the general cash to the sinking fund cash. This has the effect of creating the fund but it does not reserve the amount out of the profits. It is not thought necessary here to discuss the relative advantages and disadvantages of these two methods. It is the desire rather to draw attention to the fact that these two possibilities are present and that consequently the indenture should be read carefully in order to ascertain if possible what the intent was in this respect.

The account for discount on bonds should be analyzed. If necessary discount should be distinguished and separated from premium. The account should be observed with regard to whether or not the discount is being written off over the life of the bonds.

Legal expense deferred should be investigated in order to determine what the account really represents and to see how rapidly it is being written off. There is no reason as a rule why legal expense deferred should remain set up very long. The idea of going into it is to see that it is bona fide; that it is what it purports to be. One of the things to look out for is that current legal expenses have not been included in the amount.

Organization expense should be analyzed. The word analyzed is here used in a general way, meaning to look into the account, if necessary picking it to pieces and finding out what the details

or items represent. The auditor should satisfy himself that the account is what it purports to be and that provision has been made for writing off the amount involved within a reasonable time.

Moving expense and advertising paid in advance are practically in the same class. What was said with regard to legal expense deferred and organization expense applies to these accounts. Moving expense is sometimes incurred in moving either the plant or office from one place to another, and may with propriety be set up temporarily with the intention of writing it off afterwards.

Advertising paid in advance should be looked into to see that the amount set up is proper and that it is not being carried too long.

The account for freight on consigned goods unless abnormally large will not as a rule require any special investigation. The only thing that is liable to occur here is some slight clerical error. This account is, however, sometimes used for the purpose of burying items. Consequently the auditor will have to be guided in determining how much work he is to do in connection with this account by the size of the account when considered in relation to the volume of business and the nature of the transactions.

Interest and discount account, if such an account is found, should be analyzed carefully. While more will perhaps be said about the items in this particular account when discussing the preparation of the report, one thought which is of practical importance should be noted here. This thought concerns the summary. A great deal of difficulty and annoyance may be avoided if in summarizing the result of an analysis like that in the case of interest and discount, care is observed in setting out in the summary the dates in connection with the interest items. Suppose for example in the analysis of the interest account there is found interest on $10,000 worth of Rock Island 4's. Suppose further that the interest received was for the six months ended November 30. At the time of receipt it was charged to cash and credited to interest earned on securities. It is obvious then that if December 31 is the close of the period under audit that interest for one month on these securities will have to be accrued. By setting forth in the summary the details as to the

period covered by the interest on the Rock Island 4's it will be an easy matter to make the correct accrual at the proper time. If this is not set forth in the summary the chances are that a great deal of time will be lost by the person making up the report in searching through the papers to find the period which the interest covered. On the other hand, if such information is set forth clearly in the summary it is only the work of a moment in each case to calculate the accrual. These same remarks might have been made with equal application in the case of notes receivable and bonds and mortgages or in other securities or instruments on which interest runs.

Royalties may be either those paid or received. In either case there will undoubtedly have been a royalty contract or agreement. This should be requested and the instrument read in order to ascertain the substance thereof and the terms. Royalty is based usually on articles or goods manufactured or sold. It is well to be sure concerning the basis since some contracts are based on production and some on sales. The word "output" is sometimes used and where used the auditor should have someone who is competent place the construction on the word for him. He should make a schedule of the goods or equipment involved together with the price on which the royalty is to be computed and then ask for copies of the royalty statements which he should check.

CHAPTER XXI

Accounts on the Credit Side

Perhaps the most important item in this group is bonds. Bonds as a rule are secured by mortgages. Mortgages are frequently referred to as indentures. It is essential if an intelligent audit is to be made that the mortgage be read. Usually it contains the description and wording of the bond. The original document will rarely be seen. It is usual to receive a printed copy in pamphlet form.

The mortgage should be read for specifications with regard to such matters as the date of issue, the par of each bond, and the dates of payment thereof and for special provisions such as the following:

"Any bonds issued beyond the first five million dollars must be limited to 80% of the amount expended for additional equipment or property and no bond beyond the first five million dollars shall be issued at any time unless the net earnings of the company for the preceding year shall be equal to at least twice the interest charged for one year on the bonds outstanding and on those to be immediately issued."

If an auditor is to do his work intelligently, he should be cognizant of special provisions of this kind and keep them in mind in doing his work.

In regard to registration considerable variation will be found. Some bonds may be registered as to principal and some as to interest. Very often the following restriction will be found:

"Bonds may be registered as to principal or as to both principal and interest. Bonds once registered as to principal and interest cannot be exchanged for coupon bonds."

There may also be special stipulations as to redemption. The arrangement is frequently made that bonds may be drawn after a given number of years at a price, for example, not to exceed 105. Occasionally some of the provisions with regard to redemption are more complicated. In the case of a certain bond it is provided "that bonds shall be redeemable on April 1, 1924, at 107½ and interest and thereafter due notice being given on any interest date at a price decreasing at the rate of one-half of one

per cent yearly to maturity." All such things should be kept in mind if the work of the auditor is to be of a higher order.

Some attention should perhaps be given to the distinction between coupon bonds and registered bonds. The former have sheets of small coupons covering the payment of interest and which may be clipped from time to time as the interest becomes due. There is nothing about a coupon bond to indicate ownership. It may pass from one person to another very much like cash. The issuing company is indifferent as to the owner.

Registered bonds are quite different. Such bonds must be registered with the company or some designated registrar in order that the company may know to whom the interest is to be paid. The interest on registered bonds is paid by check. While a coupon bond is very much like a check it is drawn to bearer rather than to order. If one might imagine a number of miniature checks drawn in advance, dated in advance, printed in sheets and attached to a registered bond, a proper idea of a coupon bond would be had. In other words, there is no difference between a coupon bond and a registered bond so far as the bond proper is concerned. The difference consists merely in the provision which is made for the payment of interest in the one case. This is arranged in advance by attaching the coupons to the bond. In the case of the registered bond the checks are drawn to order from time to time as the interest matures.

An interesting question which arises in connection with the amount of bonds outstanding, is how to verify it. In the case of coupon bonds the situation is different from that in which there are registered bonds. There is one way, however, which is common to both, namely, in case the bonds are outstanding, tracing the receipts through the cash book or journal. If the bonds are outstanding it is apparent that something should have been received in exchange for them and this may have been cash. If from the inspection of the cash book this does not prove to be the case, the auditor must go a step further and search through the journal. In the case of coupon bonds the coupons are valuable in establishing fairly accurately the amount of principal outstanding. Each coupon bears the number of the bond to which it was attached. After the coupons have been paid and returned, by establishing the sequence of numbers and taking into consideration the period covered by the coupon, the amount of

bonds outstanding may be checked. As a practical matter this method may be subject to slight variation where coupons have not yet come in. The method does, however, furnish an effective check on the amount which is in the majority of cases sufficiently accurate. In a similar manner, in the case of registered bonds, the returned checks may be made to serve as vouchers not only of payment of the interest but as a check on the amount of principal outstanding.

Different concerns have different schemes for filing coupons after they have come back as a result of having been detached by the holders, put in the bank for collection, paid by the bank or trust company and returned to the company. One scheme consists in providing a book of cheap paper ruled off in spaces corresponding to the size of the coupons and pasting the coupons therein numerically. Other concerns instead of pasting the coupons in books keep them done up in packages; sometimes in small tin boxes. It is, of course, easier to count them if they are pasted into a book, as for example, if there are fifty to a page, one may count them in lots of fifty by glancing at each page to see if it has been filled up. An outstanding coupon is immediately brought to attention, whereas, it might be overlooked in counting them if they were in packages.

The amount of registered bonds outstanding may be checked, first by tracing receipts into the cash book or following the transactions through the journal. Second, by obtaining a list from the registrar or from the bond register kept by the company, and third, from the interest payments as indicated by the interest checks. The method used in the case of the interest check is not different from that where there are interest coupons.

At the time of verifying the interest paid on bonds outstanding, either through the cancelled coupons or cancelled checks which serve as vouchers, the interest accrued on the bonds outstanding may be checked. So far as the company is concerned the usual practice, altho the practice may vary, is to make an entry charging interest on bonds and crediting interest accrued on bonds. There is then transferred out of the general cash, an amount equal to the payment of interest, which amount is placed in a special deposit account with some bank or trust company or fiscal agent. As coupons or interest checks are paid and returned by the fiscal agent, interest accrued on bonds is charged and

cash on deposit for the payment of interest is credited. Two things then in the matter of verification have to be kept in mind, namely, the balance of cash in the special account on the one side and the liability for the unpaid interest on the other. The verification of the balance of cash is effected by obtaining a certificate from the fiscal agent and comparing the amount so reported with the amount ascertained by totaling the coupons or interest checks outstanding. The term fiscal agent is used here as a general term to indicate banks, trust companies and fiscal representatives. A specific illustration may serve to make clear the foregoing. Consider, for example, that the period under review is the fiscal year ended December 31, 1914. The bonds of the Blank Company bear interest which is payable at the rate of 6% per annum, January 1 and July 1; the principal outstanding $100,000. Under such circumstances $3,000 must be paid as interest on the first day of July for the six months ended June 30 and a similar amount on the first day of January for the six months ended December 31. In examining the records for purposes of audit, it is found that there appear in the books so far as the assets and liabilities are concerned, an account with a debit balance in the amount of $3,000 termed coupon deposit and an account with a credit balance in the amount of $3,000 termed interest accrued on bonds. The situation will depend, of course, on the date at which the verification is attempted. If the fiscal agents were requested to report the amount in the coupon deposit account of the Blank Company on December 31, they would naturally report $3,000. If, however, the report were requested some time in January, the balance would not be $3,000 but something less in accordance with the number of coupons or checks which had been presented to and paid by the fiscal agents since the first of January. If the balance under such circumstances as reported happened to be $630, then provided the company had received all cancelled coupons or checks, the auditor would expect to find after having examined such cancelled coupons and checks, twenty-one of same outstanding. Each coupon being in the amount of $30 the amount of such outstanding coupons would be $630. This amount being in agreement with the balance on deposit, the verification would be complete.

In the above illustration the situation is fairly simple. Complications arise where the bond interest periods do not coincide with

the end of the year. In the illustration above mentioned if the interest dates had been April and October instead of January and July, and the company had been in the habit of accruing the interest monthly, before the verification could have been effected, it would have been necessary to have deducted from the amount shown in the interest accrued on bonds account, the interest accrued from September 30 to December 31. In other words, the account interest accrued on bonds may, if the interest dates do not coincide with the fiscal year, show two things, one, interest accrued, due and unpaid, and interest accrued, not due.

Further complications in the interest accrued account will at times be encountered. Where there are several series of bonds especially where the interest is not collected promptly by the holders of coupons, the balance in the interest accrued account may, for example, be $630. This amount may be made up of amounts corresponding to the different interest coupons; $420 may represent coupon No. 25, $150 may represent coupon No. 24, $60 may represent coupon No. 23 and so on back. In the same way different series of bonds may affect the situation. Consequently in verifying statements received from fiscal agents care should be had in seeing that the interest accrued which is due and payable is not only represented in the aggregate by the coupon deposit account but that the deposit for each class of coupons or numbers as the case may be, corresponds with the liability therefor. Registered bonds are worked out in the same way except that there will be checks instead of coupons for the interest. The various outstandings should be listed and the respective accounts reconciled.

Dividends declared and unpaid are similar in their nature to interest accrued. Dividends are paid by check. The important thing to ascertain in connection with this account is that the fund on deposit equals the liability. The procedure is the same as that in the case of interest paid by check.

Loans payable are among the accounts which merit careful consideration. It might have been said while the cash book was being discussed, that it is desirable for the auditor to scrutinize the cash receipts for any receipts on account of loans or notes payable and to make, for further reference, a list of such receipts. If the auditor has failed to make a list at the time of going through the cash receipts, which might very easily happen, as it is not always convenient so

to do, he should go back and make such a list before attempting to verify the loans payable. Such list should be checked against the schedule of loans said, at the time of the audit, to be outstanding. Altho perhaps it is not done as frequently as it should be, it is a good plan to verify the loans and notes payable by correspondence. In this connection it is important that care should be exercised in the wording of the request. The party addressed should be asked to report what notes or loans against the client in question are being held. If one were to write and say "Are you holding a note of $50,000 against A. Blackwell?" such person might reply that he is holding such a note but say nothing about a further note in the amount of $25,000. If the inquiry is made sufficiently broad and is carefully worded, the information furnished is liable to be more complete.

Frequently such an inquiry will develop loans other than those shown on the books. In the same way such procedure will some times establish an endorsement relation. It may be found perhaps that a corporation has endorsed notes for some individual or vice versa and such things may be interesting to the auditor in his work. All such relations should be ascertained as far as possible as they frequently throw light on the general situation which is interesting. Of course, there is no way of ascertaining the facts if a man goes to John Jones and borrows $5,000 from him giving his note and makes no record of the note or cash on the books. The auditor will find, however, that if he follows the rule of spreading his net in every direction he will frequently discover matters of this kind in the most unexpected manner.

In connection with accounts payable one may either take a trial balance of the creditors' ledger or obtain a trial balance and check it against such ledger, agreeing the totals of the accounts payable with the control. As a general rule a trial balance will probably have been already prepared. It is seldom that one has to be taken off. This is true of the accounts payable as it is generally true of accounts receivable. If a voucher record is maintained without a creditors' ledger in connection with it as seldom happens, it will be necessary either to check the list of accounts unpaid and outstanding or prepare such a list. The open accounts so listed should be totaled and the total agreed with the balance in the controlling account in the general ledger.

Any accounts receivable which may be included in the accounts payable ledger should be taken out and set up separately. For example, the trial balance of the creditors' ledger might amount to $10,000. Such an amount might be made up of hundreds of credit items amounting to $10,000 with numerous debit balances amounting to $100, acting as offsets. It is important that in going over the trial balance such debit items should be listed and totaled in order that in preparing the balance sheet the true situation may be shown with regard to accounts payable as well as that with regard to accounts receivable. The point is that the accounts receivable may not be used in settlement of the accounts payable, consequently they may not be treated properly as offsets. Because such accounts are kept in the creditors' ledger as a matter of convenience, is no reason why they should be looked upon as reducing the liability in favor of creditors. Accounts payable is a general term as is accounts receivable. Individual accounts are something different. If such individual accounts receivable could be treated as offsets there would be no purpose in having accounts for them in the creditors' ledger since they would be applied against various individual credit balances.

Ageing accounts payable may be as interesting as ageing accounts receivable. This work in connection with accounts payable will show the relative need for funds and whether or not the credit of the concern is being strained. This is as important at times as knowing whether or not accounts receivable are good or bad. This may not, however, be undertaken without due regard for the length of time involved and the circumstances of the case in question.

While it is perhaps not as common to send out for statements with regard to accounts payable as it is to send out statements showing accounts receivable, it is a very good thing to do. Sending to creditors and asking for statements of account with them in case they do not come in as a part of the regular routine is very helpful in verifying balances. Frequently in so doing unadjusted items or items in dispute will be brought to attention. This offers an opportunity of checking up the items in question with a view to adjusting them.

Looking through the cash disbursements for invoices paid in periods to which they do not belong is an important thing to

have in mind. It quite frequently happens that business concerns will at the end of December, for example, ignore December invoices which happen to be late. In closing the books no cognizance is taken of the liability in connection with such invoices and they are simply paid in the course of time and charged in the month of January, or some succeeding month, to the appropriate expense accounts. These invoices may be found scattered along through January, February, March and sometimes as far as April. If the accounts are to be maintained on an accrual rather than a cash basis, it is necessary that such items be thrown back, as it were, so that any invoices applicable to the preceding period will be taken up in such period. In order to catch such items the auditor should observe carefully all vouchers during the first three months of the period under review as well as the three months succeeding the period. Items which do not affect the period may thus be thrown out, while items which do affect the period may be taken up. For similar reasons and extending over similar periods the cash book should be scrutinized. In connection with this work it should be kept in mind that there may be items of cash receipts and disbursements which work in the reverse way. Rent paid in December for the month of January would need to be set up if a strict accrual basis is to be maintained. Where the audit takes place immediately after the close of the period, it may be necessary to examine the vouchers of the last month with particular reference to items which are in the nature of monthly expenses so that proper accrual of these items may be made in the report. Some judgment should be used, however, in matters of this kind and the total amount involved with its effect upon the situation taken into consideration before undertaking this work.

A few words should be said as to the manner of verifying the amount of capital stock outstanding. A stock certificate book looks very much like a check book. Stock certificates have stubs just as do checks. The stub provides for the number of the certificate, the number of shares, the name and address of the party to whom it was issued, the date of issue, what it was issued for and from whom transferred, if issued in exchange for stock previously issued; also the date, number of the original certificate, number of original shares, number of shares transferred and a place for the receipt of the party to whom the stock is issued.

Of course, if the certificate is issued for cash, all this information will not appear. The stub will show in such cases the number of the certificate, the number of shares, to whom issued (name and address) and a place for the receipt. If Mr. Smith wishes to transfer two shares out of the ten which he owns to Mr. Jones, he sends in to the company or its transfer agent, the certificate calling for ten shares. The certificate is cancelled and pasted back into the book on the stub. Two new certificates are then issued, one for eight shares and one for two shares. The open stubs in the stock certificate book should then represent the stock outstanding. Consequently this offers one opportunity of verifying the amount outstanding. If the auditor will go through the stock certificate book, making a list from the open stubs showing the number of the certificate and the number of shares represented by each stub and total up such list, he will have an amount, which upon comparison, should agree with the capital stock shown, by the ledger, as being outstanding.

Another way of verifying this amount consists in taking off a trial balance, as it were, of the stock ledger. Corporations in New York state as well as various other states are obliged by law to keep a stock book. No matter what the form, the effect is that of opening a ledger account with each owner of stock showing the number of shares held by each individual owner. Taking off a trial balance from such book and making a list of the names and the number of shares held, will accomplish the same purpose as making a list from the stubs. Under one procedure the information appears according to certificates; under the other, according to owners.

Charge sales for three or four months should be tested by checking the duplicate sales slips or invoices against the sales books. Cash sales may be verified at times from the subsidiary books in which the details of the sales are entered, by footing such books and checking the totals into the general cash book.

As a check on the income which arises through interest on bonds, the interest should be followed through in order to ascertain whether or not any portion of the interest should have been credited to interest purchased, accrued interest or amortization. In a majority of cases it may be said the matter of amortization need not be considered. An ordinary mercantile concern will probably have no bonds. On the other hand, an insurance com-

pany or railroad will probably have large holdings and various bonds may be held in large blocks, so that the matter of amortization will be of vital importance. By following the interest through is meant ascertaining with regard to each holding, the situation concerning the interest at the beginning of the period and following the period through in order to see that the interest has been regularly collected and that no period has been skipped. To make clear the matter of interest purchased and accrued interest, assume for example, that a one thousand dollar bond bearing interest at 6% was purchased on the first of November. The interest dates are April 1 and October 1. Six per cent (6%) on $1,000 would be $60 for the year. One month would be $5. October 1 to November 1 would be one month. The interest involved would be $5. If the bond in question had been purchased on the first of November at par, $1,005 would have been paid for it, the $5 representing the accrued interest. On the first of the following April the coupon would be clipped and $30 would be collected. The entire $30 should not be credited to interest earned because only $25 has been earned. The other $5 is interest purchased. If it so happens that interest has been accrued on the books from the first of October to the end of December, then the $30 would have to be divided still differently. Five dollars ($5) should be credited to interest purchased, $10 to interest accrued and $15 to interest earned. Since the matter of amortization may also be involved, it will be seen that there might, under certain circumstances, be four credits in connection with interest received, namely, interest purchased, accrued interest, interest earned and amortization.

Income may also be received on account of dividends on stocks. As a step precedent to the checking of this item of income, the history of such stocks as are involved should for the period under review be looked up with regard to the dividend relations, in some publication such as The Financial and Commercial Chronicle. This information should embrace the dates of any regular, extra, special and stock dividends and the rates in each case. This furnishes an independent basis from which to work in checking the dividends receipts as shown by the books of the client.

Commissions earned will be handled much like royalties. Statements will be made up either by the principal or the agent

showing the volume of business on which the commissions are computed. The amount of commission earned as shown by the statements should be checked against the ledger account.

Exchange will usually be an account small in amount representing collection charges on out of town checks and will not usually require any attention. The account may, however, in the case of certain concerns represent the cost of foreign exchange purchased or sold, or the profit and loss on purchases and sales of foreign exchange. If the concern happens to be one which deals in foreign exchange, a subsidiary book or statements of some kind showing the details of the transactions will usually be found. If the account is of sufficient size or the transactions are of sufficient importance, the account should receive more careful treatment than where only collection charges are involved.

The profit and loss account should be analyzed. Explanation should be required of all items which are not clear. If items written off are large in amount, the auditor should ascertain by whom such entries were authorized. It is perhaps not a bad idea to analyze the profit and loss account during the early part of the engagement rather than leave it until the end as it often develops leads which may be used to advantage in analyzing other accounts.

CHAPTER XXII

How to End an Audit

Before leaving the office of the client or the place in which the work has been carried on, the trial balance and supporting analyses and summaries should be looked over and journal entries made for any matters which require adjustment. If it is not possible to make the journal entries at the time the information should be jotted down so that it will be available when needed. It is preferable that journal entries be made immediately while the matter is fresh in the mind and so that proper and adequate explanation may be made. This is so that if anything develops which requires attention, access to the books and records may be had or any questions may be asked before leaving. By adjustments is meant any changes or corrections in the figures as shown in the books, or any additions thereto.

Adjustments may be roughly divided into three classes:

First, adjustments to cover things done which should not have been done. These are sometimes called errors of principles or errors of commission.

Second, adjustments to cover things which have been done but have been done incorrectly. Under this head come clerical and offsetting errors and errors in the mechanical work.

Third, adjustments to cover things which have not been done. These are frequently referred to as errors of omission.

As an illustration of the first point may be mentioned capitalizing expense. One of the principles of accounting is that any debit item which does not add to the value of property or otherwise increase the assets should be charged to expense. The bookkeeper may not have a clear understanding of this point and may charge certain items of expense to the property accounts. An error not uncommon in this respect is that of charging taxes to the cost of property. This it should be understood is property which is being operated and not that which is being developed by

a real estate concern for sale. The charging of taxes to the property account constitutes an error in principle.

In the second class there are of course many more possibilities. Among these are incorrect figuring, extending or footing of sales invoices, mistakes in preparing vouchers, mistakes in making entries in the books, mistakes in posting, footings carried forward, etc. These errors while perhaps of greater frequency, are less liable to involve large amounts and are as a rule of less importance.

Failure to set up unexpired insurance, if the amount is of sufficient importance, at the time of closing the books, constitutes an example of an error of omission. In fact failure to make proper accruals at such time may probably be said to account for most of the errors of omission. There may also be included such matters as crediting sales of securities and accrued interest temporarily to the securities account and failing to clear the account properly at the time of closing the books.

A few entries in illustration of adjustments follow:

Endowment fund	$100.00	
To Endowment fund reserve		$100.00
To correct error in charging the reserve and crediting cash when investing the fund.		

Subscriptions	$25.00	
To Sustaining members		$25.00
To correct error in posting.		

Interest payable	$163.58	
To Interest accrued		$163.58
For interest accrued on note of $5,392.92; six months at 6% per annum.		

Accrued interest	$23.77	
To Interest		$23.77
To set up interest credited by the Title Guarantee & Trust Company and not taken up in the income at December 31, 1914.		

Unexpired insurance		$391.68	
To Insurance			$391.68
To set up the unexpired insurance premiums at December 31, 1914.			

Accrued interest on investments		$335.52	
To Interest on investments			$335.52
To set up on the book the accrued interest on investments at the time of closing the books December 31, 1914:			
Central Railroad of New Jersey bonds	$6.25		
New York City corporate stock	3.54		
Bonds & mortgages:			
Baer	67.73		
Dean	37.50		
Chadwick	35.00		
Munson	81.25		
Wahlsen	104.25		
	$335.52		

City of New York			$165.57	
To Care of patients, City of New York				$165.57
To adjust the estimated charges against the City of New York to the actual charges:				
Actual:				
November, 1914	$1,600.57			
December, 1914	1,265.00	$2,865.57		
Estimated:				
November, 1914	$1,300.00			
December, 1914	1,400.00	$2,700.00		
Excess of actual over estimated		$165.57		

During the course of the work on the engagement there will perhaps have been made a list of matters which the auditor desired to look into or ask questions about. These notes may have been made on a sheet of journal paper or any piece of paper which happened to be convenient. Such lists should now be

looked over carefully to make sure that everything is clear; that everything has been looked up; and that there are no questions in connection with these memoranda which the auditor now wishes to ask.

The papers and books should be returned in the same order in which they were received. By that is meant that they should not be out of order, scattered about, or disarranged. These may seem like small details and highly theoretical. As a matter of fact they are not. They count for a great deal. If papers are received in a certain order they should be kept in that order if possible and not disarranged. They should be given back in the same order received and not left about so that they will have to be hunted up by the client's employes. Some judgment will of course be necessary in this respect. Papers may of necessity have gotten out of order and it may be to the advantage of the client to have a six dollar a week clerk put them back in order rather than to have a man whose services cost twenty-five dollars a day do the work. Under such circumstances it may be better to go to the person from whom the papers were received and explain the situation, arranging accordingly respecting the matter. The thing which people dislike is to have the auditor leave without returning the papers and without saying anything about it. Psychology plays an important part in the auditor's work. It operates for or against him in accordance with how he uses it. A man will probably be forgiven for bringing back a file of papers which are disarranged if he explains and apologizes for the condition in which they are returned. The chances are that they will be received gracefully and the matter will occasion little disturbance. If they are thrown on someone's desk without any explanation, the chances are almost certain that the impression created will be an unfavorable one. Consequently the importance of being sure before leaving that everything has been properly returned.

It is worth while before leaving to go around and bid the employes with whom one has come in contact, goodbye. One should not be afraid to shake hands. It will not do any harm even though it soils one's hands occasionally. To grip the hand of a man working on a lathe in a machine shop is not at all beneath the dignity or position of the auditor. It will engender a friendly feeling on the part of the machinist and the grease

and oil will come off later. It is not amiss before leaving to let the employes know that one thinks enough of them to bid them goodbye and perhaps say a word to the effect that the courtesies extended by them have been appreciated.

It is not the practice to write the report in the office of the client or the place in which the work has been done. The auditor as a rule gathers his material and returns to his own office for the preparation of the report. There are certain arguments for and against this practice. Better reports would probably be written if they were written in the client's office. If, under such circumstances, there were any questions arising in connection with the writing of the report, it would be an easy matter to make the inquiry. If any questions should arise requiring reference to the books, they would be immediately available. No matter how far ahead one thinks or how carefully one plans there is apt to be something overlooked or something which has not been provided for. On the other hand, there is some objection to preparing the report in the office of the client because of the fact that portions of the report as it is being prepared might be overseen by some of the employes of the client. It is quite natural that the auditor should develop informal acquaintanceship with certain employes who might in stopping to chat during their spare time, look at the papers spread out before the auditor and see something which was intended to be conveyed in confidence to the client. The tendency on the part of employes is to be curious as to what the auditor is putting into the report. If the report is not prepared in the client's office this opportunity is removed.

CHAPTER XXIII

What to Do After an Audit

It should be understood that what is about to be said concerning reports and their preparation, is not laid down as standard practice. It is presented merely as the practice which has come within the experience of the author. That it is used, however, by one of the largest and most successful firms in the profession, should give it sufficient standing.

After returning to his office the auditor proceeds with the preparation of the report. The report is prepared first in the rough by the man who has charge of the engagement. That is to say, he writes out in pencil or pen and ink his entire report in rough form, after which it is typed in the rough.

For purposes of discussion the report may be divided into four parts: the presentation, the certificate, the comments and the statements. It is customary to prepare the statements first, then the comments, after which come the certificate and the presentation.

Statements are prepared first in the rough on analysis paper and journal paper. They may be divided for report purposes into two classes: exhibits and schedules. Exhibits are usually prepared on analysis sheets, while schedules may be prepared on journal paper or analysis paper torn in two so that it will be about the size of journal paper. The exhibits are denoted by letters; the schedules by numbers, and both exhibits and schedules are marked as a rule at the bottom of the page. The typical exhibits are the balance sheet, statement of income and profit and loss and sometimes the statement of cash receipts and disbursements. These exhibits are supported by schedules. Where there is an item on one of the exhibits in which it is desired to show the details, a schedule is used. The balance sheet, for example, will be marked Exhibit "A". On this balance sheet there may be, for example, an item—"land and buildings". It may be desirable to show the details of the item, when a schedule will be used. The schedule may be designated "Schedule showing details of land and buildings". It will be marked at the bottom —"Exhibit 'A', Schedule No. 1". The statement of income and

profit and loss will usually be designated as Exhibit "B". Again there may be occasion for supporting some of the items by schedules. The profit and loss charges may be numerous so that instead of listing them all in the exhibit, it will be preferable to show them in a schedule. Such a schedule might be headed "Schedule showing details of profit and loss charges". It would likewise be marked "Exhibit 'B', Schedule No. 1."

These statements will be made up from the working sheet and the analyses of the different accounts which support the working sheet together with the adjustments which have been made. It is perhaps at this time that the novice will appreciate better than ever before the practicable benefit of the working sheet. Starting with the figures on the client's books, any changes or adjustments or corrections having been journalized, if these journal entries are now posted to the working sheet in the adjustment columns, the figures will be brought into shape for use in the report. This seems to make the work very complete. It establishes a connection between the two sets of figures and saves the auditor all anxiety as to what he may have done in adjusting the figures on the client's books. Very often after having gone out to another engagement, since as a rule he is unable to remain in the office until the report is typed and delivered, the auditor who did the work will be called upon to explain something in connection with his report. Having his thoughts centered on the work in which he is at present engaged, it is not an easy matter to shift to the previous set of working papers and explain immediately just what was done. Possibly six weeks after the report was written, someone in the office will want information concerning it. Sometimes also it is necessary after the report has been rendered, to discuss certain phases of it with the client or some of his representatives. With the working sheet and the supporting papers properly arranged, the auditor has no difficulty in answering quickly at any time, any questions which may arise in connection with the report.

In making rough copies of statements it is important that they should be written exactly as they are to be copied. Nothing should be left to the imagination or intelligence of the copyists. This is on the assumption, of course, that it is the practice to write out the reports and have someone else copy them. Such will be the case nine times out of ten. These copyists make what

they call "Chinese" copies. They copy just what they see and they do not stop to think whether it is right or wrong. They have all they can do to make the copy exact. Getting the proper spacing is not the least difficult part of their work. Consequently, if one wishes to have words like furniture and fixtures spelled out in the typewritten copy, the words should be written that way in the rough. If the abbreviation "furn. and fix." is used in the rough, it will be typed that way in the copy. This may not of course be invariably true, since some large offices with elaborate report departments have a standing rule that no abbreviations are to be used.

Comments, sometimes referred to as the essay section of the report, have four main purposes:

First, to bring sharply to the attention of the reader a particular fact which might be passed over in the examination of the statements.

Second, to explain or make clear certain figures in the statements.

Third, to describe the work which has been done and perhaps tell what has not been done.

Fourth, to present criticisms, suggestions, or recommendations; the latter only in case they are requested.

As an illustration of the first point, one might say—"It should be noted that the figures shown in the report are in this particular the correct ones and not those which appear in the books of the client."

In the same way in connection with the item—land and buildings, for example, the following might appear—"This account represents the purchase price ($27,500) and improvements and betterments ($3,892.90) of the property known as Waverly House, No. 38 West Tenth Street, New York City." It might be true in a case of this kind that both the purchase price and improvements could be shown in the balance sheet. If that idea is followed, however, it is apt to lead to a balance sheet which is complicated and heavy rather than one which is neat and concise as it should be. Comments therefore offer an opportunity of maintaining the statements in a form which is clean and concise, even though it is necessary to give detailed information concern-

ing matters of this kind. In connection with this point comments are also used for the purpose of showing details, where the details are not sufficient in number to warrant the preparation of a schedule. As an illustration of this, the following may serve:

Furniture and Fixtures as shown in Exhibit "A"

This account is composed of the following items:	
General office in Waverly Place	$1,500.00
Employment exchange	500.00
Mental work	525.00
Extension work	475.00
Protective league	800.00
	$3,800.00

In the above illustration there are five items. It would not be practicable to set these items forth in the balance sheet. It is important, however, that the make-up of the item of $3,800 as it appears in the balance sheet, should be explained, or the details shown somewhere. There are not sufficient items to warrant the preparation of a schedule. The comments therefore serve admirably to bring out a matter of this kind.

In some cases the auditor desires to have understood precisely what he has done and what he has not done. He may say, for example, concerning the accounts receivable—"I have tested the accounts receivable by checking the subsidiary records to the controlling account," or "I have not been able to verify completely the income from subscriptions because of the fact that certain of the records were missing at the time of the audit and were not subsequently produced."

There is considerable difference of meaning among the words criticism, suggestion and recommendation. The auditor should never hesitate to criticise anything in connection with the accounts or the accounting. The criticism should be tactful and above all constructive. A classic injunction of one of the leaders in the profession, reproduced without the profane touch, which it must be admitted gave it considerable force is, "be constructive and not destructive." Fault must not be found simply for the purpose of finding fault or making it appear that the auditor is very efficient. Such is not the spirit in which criticism should

be made. It is a part of the auditor's duty to point out where things are wrong. He should not, however, do this unless he is in a position to say also what should be done to correct the trouble or improve the situation. If the auditor is obliged to tear down, he should have something ready to put in its place.

In a recent engagement a payroll book was found in which it was the practice to write each month, the name of each employe, with the amount earned, and have the employes sign the book at the time of receiving their wages. There were about fifty or sixty such employes. This situation offered an opportunity for constructive criticism. The client was told that the practice was not a good one; that it resulted in waste time, and, furthermore, permitted one employe to find out what others received, thereby giving a chance for gossip and the breeding of dissatisfaction. The criticism was followed by the suggestion that there be introduced a book provided with columns and short leaves so that the name of each employe need be written but once during the year, and the amounts corresponding to the respective months inserted in the appropriate columns. For the purpose of getting a receipt, a printed slip was suggested. This required only the insertion of the date and amount. The client saw immediately the whole situation. He realized that the criticism was just and that something better had been offered to take the place of the part of the system criticised. The suggestion was immediately adopted and the new scheme put into effect.

Generally speaking recommendations should not be made unless they are asked for. They should also be confined to matters of accounting. There is no warrant for the recommendation by the auditor, that the lighting system be changed because the light does not agree with his eyes, or that buildings covering several acres be torn down and replaced by new buildings because the arrangements with regard to the routing of goods is not ideal. As an illustration of a recommendation which was presented in response to a request on the part of the client for any recommendation which might seem desirable, the following is given:

"Under the present method of handling commissions the cash receipts only from these sources are taken into the general books. There appears to be no control of the journal charges for these commissions. It would seem to be advantageous to show upon

the books the commissions at the time they were earned; that is, at the time of placing the applicant in the position. This plan would also establish a control over the commissions charged, which it is believed would assist the bureau in handling this, the main one of its accounting problems.

"The introduction of two books known as the commission register and the commission discount register respectively would provide a medium for carrying out the work as above suggested."

Rulings for these books were then submitted to the secretary. This could not have been done with propriety unless the person in authority had said—"We shall be glad to have you make any recommendations or point out anything that occurs to you as being possible of improvement."

Care should be observed as to the tone of the comments. Above all things they should not give offense. Care should be observed as to what is said and how it is said so as not to incur the illwill of any person who reads the report or is affected thereby. Remarks should not be abrupt or unduely frank. They should be tempered and not made too harsh. This does not mean that the truth as one sees it may not be told. There are two ways of saying things. One may point to a light and say—"That is an indirect light," or it may be put in a different way, namely, "That appears to me to be an indirect light." The latter has accomplished the same purpose as the former. Attention has been directed to the light which was the object of the remark. If the positive statement that the light in question is an indirect one is made, it may be possible that someone whose attention is directed to the light will be an engineer who will challenge the remark and take the speaker up on a technicality and prove that it is not an indirect light. It is well for the auditor never to make a statement which he cannot prove. It is better to quality one's remarks unless one is absolutely sure of the facts and ready to prove them in court if necessary. These points are illustrated by the following extract from a recent report:

ENDOWMENT FUND INVESTMENTS

"The following securities comprise the endowment fund:

"The above securities with the exception of the two guarantee mortgages were verified by examination at the safe deposit vaults of the Broadway Trust Company at Eighth Street." The mortgages of Sampson & Hendricks were at the time of the audit de-

posited with the Title Guarantee and Trust Company as security for a note of $4,923.86 and were verified by correspondence with the Trust Company.

"The authorization of the treasurer to deposit these endowment fund securities as collateral for a loan was given by the board of trustees as reported in the minutes of November 20, 1914, as follows: 'On motion, it was resolved that the treasurer of the Bank Organization be hereby authorized to dispose of investments and sell securities of this corporation to the amount of $4,923.86 for account of building fund, and hereby is authorized to borrow the said amount from the Title Guarantee and Trust Company upon the guaranteed mortgages held by this corporation pending an opportunity to dispose of same to advantage.'

"While therefore the pledging of the securities has the approval of the board of trustees, the moral aspect of hazarding the endowment fund, by pledging securities representing it, for a loan is perhaps unquestionable, since such procedure might amount to a conversion of the endowment fund to current purposes. It is in the opinion of the auditor desirable that the endowment fund be analyzed with regard to the endowments which were intended by the donors to be of a permanent character and those which were not, and that in accordance with such classification, the amount of the permanent fund be fixed by the board of trustees with the idea of preserving it."

What had happened in this case was that securities which were a part of the endowment fund had been deposited as collateral for a loan to the building fund. If anything had happened that the loan could not have been paid, the securities would have been sold and it would have been equivalent to converting securities of the endowment fund to the building fund.

The handling of this matter in the comments required a great deal of tact. No offense was given, but no doubt was left in anyone's mind as to what was thought regarding the situation. The facts were pointed out in a forceful but inoffensive way, and the remedy for removing any suspicion of error or moral negligence was suggested. As near as could be ascertained none of these funds were legal trusts. They were funds which had been given in one form or another by persons who had asked that they be set aside for special purposes. The board, it was said, felt that since certain of the assets had been put into the fund arbitrarily by action of the board, nothing wrong was being done when the securities were taken out of the fund. The statement was not made that the members of the board were legally

liable or that they were guilty of any illegality in what they did. It looked, however, on the surface as if they were converting funds and using them for the purpose other than that for which they were intended. The comments in the case in question instead of giving any offense, resulted in doing exactly what was suggested. The feeling remained a friendly one. The board felt that it had been criticised but that the criticism was a constructive one and had been made in an inoffensive manner.

It is desirable as a rule that the impersonal form be used as far as possible. Instead of using "we think," it seems better to say "it is thought." Of course it sometimes happens that the personal form will be desired, since the phrase "in our opinion" is frequently seen in certificates. Such expressions as "your committee," "your treasurer," etc., are not good form. It is better as a rule to use the title of the position which the person in question occupies. As far as possible the mentioning of names should be omitted. Instead of saying "Mr. Foote told us so and so," it is better to say "upon information from the secretary," or "it is understood from the secretary."

In writing the comments it is considered good practice to follow the order in which the items appear in the statements. In beginning it may be necessary to write an introductory paragraph, but immediately following the various matters should be discussed in the order in which the items to which they relate, appear in the statements. In accordance with this rule, land and buildings is usually the first item to receive attention.

Good construction advocates the use of simple words, short sentences and non-technical expressions as far as possible. By so doing someone may be bored, but it is much better to use language which the ordinary man understands rather than to attempt to impress readers with literary style. It is not necessary to indulge in literary style. All that is required is to express such thoughts as a person may have in connection with a technical subject in a clear, concise way which the layman will understand. The professional auditor is not expected to be a literary expert. He is expected to have an accounting sense and to understand accounting, and to be able to use English sufficiently well to express clearly what he has to say on the subject.

Before taking up the subject of the certificate, it is probable that some consideration should be given to the object thereof.

A person would not think of building a house without engaging an architect. This is because of lack of technical knowledge of materials and construction work. An architect is skilled in such matters and accordingly there is confidence in his judgment. He is engaged to draw the plans and, in most present-day cases, to supervise the construction work. In the same way a lawyer is engaged where legal matters are involved. Not understanding the law nor being skilled in its practice, a person is unable as a rule to defend himself. If he becomes involved in a legal action, the layman is not supposed to know anything about the technique concerned with the preparation and trial of a case. Such is the business of a lawyer. Being skilled in these matters, one has confidence in his judgment and feels that he will extend the proper advice and care of the interest involved. In precisely the same way should the relation existing between, client and accountant or auditor be looked upon. Generally speaking, the client knows little about accounts or accounting. To him their philosophy or theory, their treatment, and interpretation is at least far from being thoroughly understood. He may employ an accountant to do this work for him. Not knowing whether the statements are correct or incorrect, or what they mean, he puts his case into the hands of the auditor who is skilled in accounts and accounting as a result of training and experience, for the purpose of obtaining his opinion as to the accuracy thereof. It is a technical matter of which most clients are not competent to judge, and an auditor is employed to represent the client and advise him as to the results. The object of a certificate then is to obtain from an unbiased person who is skilled in the matter of accounts and accounting, an opinion as to their accuracy.

Certificates are of two forms. One is known as the short form; the other the long form. The following is a specimen of the short form:

THE WARBURTON DESK COMPANY

CERTIFICATE

We have made an audit of the accounts of the Warburton Desk Company for the year ended December 31, 1914, and

WE HEREBY CERTIFY that the accompanying General Balance Sheet and Statement of Income and Profit and Loss are correct, and, in our opinion, subject to the accompanying comments, set forth the true financial condition and result of operations respectively on said date.

JONES & PARKER,
Certified Public Accountants.

New York, March 20, 1915.

It should be noted that the certificate may take the form of a separate sheet or appear at the bottom of the balance sheet. In the latter case, the wording would need to be changed a trifle so as to read "the above balance sheet and accompanying statement of income and profit and loss, etc."

The long form which follows is taken from a semi-public report and is that of a firm of certified public accountants. It appears as sent out, except that the names have been changed.

THE AMITY MANUFACTURING COMPANY

CERTIFICATE

We have audited the books and accounts of The Amity Manufacturing Company for the year ended October 31, 1914; we have verified the cash and notes receivable and checked the prices and calculations of the inventories on hand taken by the company's employes; we have tested the accounts receivable by checking the subsidiary records to the controlling account and believe that the reserve provided for doubtful accounts is sufficient to meet the losses which may be sustained in the collection thereof. The other reserves provided are believed to be sufficient for the purposes for which created, and

WE HEREBY CERTIFY that, in our opinion, the accompanying General Balance Sheet as of October 31, 1914, and Statement of Income and Profit and Loss for the year ended that date are correct.

(Signed)
STREET & BROWN,
Certified Public Accountants.

New York,
November 27, 1914.

The above certificate is sometimes referred to as a qualified certificate. Very often, however, the qualifications are of a negative character instead of positive as above. Some time the certificate reads: "We have not inspected the securities," or "We have not verified the inventories in accordance with the understanding with the secretary of the company to the effect that we should not do so."

While it is not the intention to enter into a lengthy discussion of the merits and demerits of the two certificates, one thing should be pointed out. The first certificate shows that the statements are correct and set forth true financial condition, etc. The second one shows only that the statements are correct. While it is perhaps the intention to imply in the latter case that the statements show financial condition and result of operation, the fact is not so stated. Apparently the statement might be correct according to the books while the books might not show true financial condition. This form of certificate has been criticised considerably in this respect. Lawyers have given the opinion that the second certificate would not have as much value to the client at law as the first. It has been suggested that the testimony of the accountant signing the second form of certificate would not have as much weight in court as if the first form had been used.

One thing seems certain that if an auditor is to occupy the proper position in the business field, that of high professional standing, and be well compensated for his services he must accept a certain amount of responsibility for the work which he does. To do work as an auditor and accept money for it without the corresponding responsibility seems neither fair nor ethical. If such things take place, the profession instead of being elevated to a high plane, will degenerate into a money grabbing vocation.

The presentation consists of a letter typed on the business stationery of the auditor, submitting the report. It serves in a way as an index to the report, since it sets forth and describes the exhibits and schedules. The presentation is usually the last part of the report to be prepared, but occupies the first position when the report is made up. The main parts into which the report is divided are arranged as follows: presentation, certificate, comments, statements. A specimen presentation will be found on page 179, followed by other specimen parts of the report.

As to the form which a report shall take, there is a choice of

top or side binding. Where the top binding is used the single sheets are inserted in the fold of the cover, punched through and strapped or otherwise fastened. The report in this form may be folded if desired. The other form is bound on the side. Single or double sheets may be used, the single sheets preferably, because of the fact that if mistakes are made on double pages, the entire page has to be rewritten. If single sheets are used the possibility of rewriting is reduced. The sheets are inserted into the cover and fastened at the back with wire staples or cloth fasteners. In such form the report may be opened and read as a book.

In typing the report it is customary to make six copies; that is, an original and five carbons. This is in order that one copy may be used for proving purposes, another for the file and four copies for the client if required. Sometimes clients will desire two copies and sometimes three. This leaves one as a margin in case an additional copy is required later. While the report is being typed it is easier to make more copies than are required than to be obliged to re-type the entire report.

The report department does the comparing, the proving and checking of figures and the checking of references. The report is first prepared in the rough and then written on the typewriter by the copyists. After being typed it is compared with the rough. As far as possible all figures are proven. Any additions, subtractions, multiplications, divisions, percentages or rates are carefully gone over. Wherever figures appear which may not only be checked but proven, such proof is obtained. Wherever figures appear in the comments they are checked to the statements in order to be sure that the accountant in writing the comments has not made mistakes in setting down the figures.

The last step in so far as the auditor is concerned is not the least important. It consists of putting the papers away. The analyses, the sheets showing details which support the trial balance, will have been numbered. These numbers should appear on the trial balance on the line with or in front of each corresponding account. The amount shown by the analyses should agree with the amount shown in the trial balance. If, for example, it becomes necessary later to look at the items making up the account "land and buildings,'" reference may be had to the trial balance where finding the reference to be No. 1, analysis sheet

No. 1 may be located when the information will be available. The trial balance should be folded into which, arranged in numerical order, the analyses should be inserted. All miscellaneous papers or scraps of papers should be saved and inserted in the trial balance. On top of the trial balance should be placed the rough statement and report and a copy of the finished report. All this should then be inserted in a stiff paper folder, writing on the outside of the folder the title of the engagement and the period covered. The papers may then be left with the satisfaction of work well done and the feeling that no matter who happens to refer to the papers in the future everything will be found in order.

[FINIS]

CRITERION MANUFACTURING COMPANY

REPORT
ON AUDIT OF THE ACCOUNTS
FOR THE YEAR ENDED DECEMBER 31, 1914

JOHN R WILDMAN
CERTIFIED
PUBLIC ACCOUNTANT
22 WAVERLY PLACE
NEW YORK CITY
SPRING 4233

JOHN R. WILDMAN
CERTIFIED
PUBLIC ACCOUNTANT
32 WAVERLY PLACE
NEW YORK CITY
SPRING 4833

New York, March 20, 1915.

Mr. Ellis H. Reed,

President, Criterion Manufacturing Company,

165 Broadway, New York.

Dear Sir:

In accordance with engagement, I have made an audit of the accounts of the Criterion Manufacturing Company for the year ended December 31, 1914, and submit herewith a certificate, five pages of comments, and the following exhibits and schedule:

EXHIBIT
"A" - GENERAL BALANCE SHEET - DECEMBER 31, 1914.
Schedule
#1 - Statement of investments in bonds of kindred companies.

"B" - STATEMENT OF INCOME AND PROFIT & LOSS FOR THE YEAR ENDED DECEMBER 31, 1914.

Yours truly,

Jno. R. Wildman

Certified Public Accountant.

JOHN R. WILDMAN
CERTIFIED
PUBLIC ACCOUNTANT
32 WAVERLY PLACE
NEW YORK CITY

SPRING 4233

CRITERION MANUFACTURING COMPANY.

CERTIFICATE

I have made an audit of the accounts of the Criterion Manufacturing Company for the year ended December 31, 1914, and

I HEREBY CERTIFY that the accompanying General Balance Sheet and Statement of Income and Profit & Loss are correct, and in my opinion, subject to the accompanying comments, set forth the true financial condition and result of operations respectively on said date.

Jno. R. Wildman
Certified Public Accountant.

New York,
March 20, 1915.

CRITERION MANUFACTURING COMPANY

COMMENTS ON THE AUDIT
FOR THE YEAR ENDED DECEMBER 31, 1914

PROPERTY AND PLANT

The figure at which these assets are shown in the balance sheet is that at which the property was appraised when taken over from the firm of Lamson & Higgins.

NOTES RECEIVABLE ACCOMMODATION

This item represents notes of the National Products Company bearing interest at six per cent. These notes were taken from the above company and discounted for the purpose of supplying same with current funds. The notes will mature June 30, 1915. They are set up, with the contra, in order to show the contingent liability of the Criterion Manufacturing Company.

ACCOUNTS RECEIVABLE

The trial balance of the customers' ledger was checked and the ledger agreed with the controlling account. The individual balances were not confirmed owing to the objection raised by the company with regard to the sending out of statements.

GENERAL

The practice of the company in the handling of remittances received through the mail is open to some criticism. At the time of the audit, checks received in the mail were being turned over immediately to the customers' ledger bookkeeper to be credited to the individual accounts affected after which they were entered in the cash. This it was explained was because checks are frequently wrong in amount and have to be returned, or held pending correspondence concerning them. This practice should be discontinued. The checks should be first entered in the cash in order that proper control may be established and maintained. Subsequently the checks, or preferably a remittance sheet, may be given to the bookkeeper for posting purposes. All checks should be deposited as soon after receipt as possible.

Page 1.

CRITERION MANUFACTURING COMPANY

GENERAL BALANCE SHEET - DECEMBER 31, 1914

ASSETS

PROPERTY AND PLANT:		
Land,	$ 10,000.00	
Buildings,	50,000.00	
Machinery and equipment,	65,000.00	
Automobile trucks,	8,000.00	
Total property and plant,		$133,000.00
INVESTMENTS - BONDS OF KINDRED COMPANIES - Schedule #1 (par value),		44,500.00
WORKING AND TRADING ASSETS:		
Raw material,	$ 38,000.00	
Work in process,	22,000.00	
Finished goods,	57,000.00	
Total working and trading assets,		117,000.00
CURRENT ASSETS:		
Cash in hand and on deposit,	$ 14,500.00	
Accounts receivable,	195,300.00	
Notes receivable,	10,200.00	
Notes receivable accommodation (see contra)	14,500.00	
Total current assets,		234,500.00
DEFERRED CHARGES TO EXPENSE:		
Unexpired insurance premium,	$ 500.00	
Mercantile agencies fees,	200.00	
Warehouse charges prepaid,	300.00	
Total deferred charges to expense,		1,000.00
TOTAL ASSETS,		$530,000.00

EXHIBIT "A"

CRITERION MANUFACTURING COMPANY

GENERAL BALANCE SHEET - DECEMBER 31, 1914

LIABILITIES
AND CAPITAL

CAPITAL STOCK - 2,000 SHARES OF $100.00 EACH,		$200,000.00
REAL ESTATE BOND AND MORTGAGE,		40,000.00
CURRENT LIABILITIES:		
Salaries and wages accrued,	$ 2,500.00	
Accounts payable,	53,000.00	
Notes payable,	62,000.00	
Notes receivable accommodation discounted (see contra),	14,500.00	
Dividends declared,	40,000.00	
Total current liabilities,		172,000.00
RESERVES:		
Depreciation of buildings,	$ 5,000.00	
Depreciation of machinery and equipment,	13,000.00	
Depreciation of automobile trucks,	3,200.00	
Contingencies,	5,000.00	
Total reserves,		26,200.00
PROFIT & LOSS SURPLUS - EXHIBIT "B",		91,800.00
TOTAL LIABILITIES AND CAPITAL,		$530,000.00

EXHIBIT "A"

CRITERION MANUFACTURING COMPANY

STATEMENT OF INVESTMENTS IN BONDS OF KINDRED COMPANIES - DECEMBER 31, 1914

Alliance Manufacturing Company, 6% Bonds, due 1925, interest payable January and July - par value,................................	$10,500.00
Affiliated Manufacturing Company, 7% Bonds, due 1920, interest payable January and July - par value,............................	10,000.00
National Products Company, 6% Bonds, due 1915, interest payable January and July - par value,................................	4,000.00
American Company, 6% Bonds, due 1928, interest payable January and July - par value,....................................	12,500.00
Consolidated Trading Company, 6% Bonds, due 1917, interest payable January and July - par value,................................	7,500.00
TOTAL..................	$44,500.00

EXHIBIT "A"
SCHEDULE #1

CRITERION MANUFACTURING COMPANY

STATEMENT OF INCOME AND PROFIT & LOSS
FOR THE YEAR ENDED DECEMBER 31, 1914

SALES,		$750,682.90
LESS - RETURNS,		1,560.80
NET SALES,		$749,122.10
DEDUCTIONS FROM SALES:		
Allowances,	$ 428.00	
Outward freight and cartage,	6,015.32	
Total,		6,443.32
INCOME FROM SALES,		$742,678.78
MANUFACTURING COST OF GOODS SOLD:		
Purchases of raw materials,	$265,826.48	
Inward freight and cartage,	5,820.00	
Total,	$271,646.48	
Add - Decrease in inventory of raw material	3,842.69	
	$275,489.17	
Direct labor,	197,823.32	
Superintendence,	2,478.23	
Factory office salaries,	7,859.65	
Heat, light and power,	25,800.00	
Factory supplies,	15,306.50	
Factory expense,	5,380.75	
Factory repairs,	3,181.00	
Depreciation of operating equipment,	6,500.00	
	$539,818.62	
Deduct - Increase in inventory of goods in process,	5,600.00	
Total manufacturing cost,	$534,218.62	
Add - Decrease in inventory of finished goods,	2,628.00	
Total manufacturing cost of goods sold		536,846.62
GROSS PROFIT ON SALES,		$205,832.16
SELLING EXPENSE:		
Salaries of sales manager and clerks,	$ 15,900.00	
Salaries of salesmen,	10,000.00	
Salesmen's commissions,	37,434.70	
Traveling expense,	6,743.47	
Advertising,	14,105.94	
Total,		84,184.11
SELLING PROFIT - (Forward),		$121,648.05

EXHIBIT "B" (Continued) - 1.

CRITERION MANUFACTURING COMPANY.
STATEMENT OF INCOME AND PROFIT & LOSS, ETC.

SELLING PROFIT - (Forward),		$121,648.05
ADMINISTRATIVE EXPENSE:		
Salaries of officers,	$ 25,000.00	
Salaries of clerks,	17,850.55	
Stationery and printing,	4,640.00	
Postage,	2,800.00	
Telephone and telegraph,	1,475.89	
General expense,	5,648.00	
Total,		57,414.44
NET PROFIT ON SALES - INCOME FROM OPERATIONS,		$ 64,233.61
OTHER INCOME:		
Income from securities,	$ 2,770.00	
Interest on notes receivable,	410.00	
Cash discount on purchases,	916.53	
Total,		4,096.53
TOTAL INCOME,		$ 68,330.14
DEDUCTIONS FROM INCOME:		
Interest on bond and mortgage payable,	$ 2,000.00	
Interest on notes payable,	3,100.00	
Cash discount on sales,	3,285.76	
Insurance,	1,000.00	
Taxes,	850.00	
Total,		10,235.76
NET INCOME - PROFIT & LOSS,		$ 58,094.38
PROFIT & LOSS CREDITS:		
Profit on purchase of Consolidated Trading Company 6% Bonds,	$ 300.00	
Profit on purchase of National Products Company 6% Bonds,	160.00	
Total,		460.00
PROFIT & LOSS - GROSS SURPLUS FOR THE PERIOD,		$ 58,554.38
PROFIT & LOSS CHARGES:		
Provision for depreciation of buildings,	$ 2,500.00	
Provision for contingencies,	2,500.00	
Total,		5,000.00
PROFIT & LOSS FOR THE PERIOD,		$ 53,554.38
PROFIT & LOSS SURPLUS AT BEGINNING OF PERIOD,		78,245.62
PROFIT & LOSS SURPLUS BEFORE DEDUCTING DIVIDENDS,		$131,800.00
DIVIDENDS DECLARED,		40,000.00
PROFIT & LOSS SURPLUS, DECEMBER 31, 1914,		$ 91,800.00

EXHIBIT "B" (Concluded) - Z.

INDEX